



## **Caribbean Financial Sector Assessment**

Submitted by:

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# FORWARD

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A&B	Antigua and Barbuda
BCSDI	Barbados Central Securities Depository, Inc.
BDA	Barbuda
BNB	Barbados National Bank
BNS	Bank of Nova Scotia
BSA	Banking Sector Assets
BSE	Barbados Stock Exchange
CARICOM	Caribbean Community
CARTAC	Caribbean Regional Technical Assistance Center
CBB	Central Bank of Barbados
CCCU	Caribbean Confederation of Credit Unions
CDB	Caribbean Development Bank
CIBC	Canadian Imperial Bank of Commerce
CIDA	Canadian International Development Agency
CLICO	Colonial Life Insurance Co.
CMMB	Caribbean Money Market Brokers
CPPS	Core Principles of Payment Systems
CPSS	Committee on Payment and Settlement Systems
CRP	Caribbean Regional Program
CSD	Central Securities Depositories
CTO	Cognizant Technical Officer
CU	Credit Union
CUSU	Credit Union Supervisory Unit (Trinidad and Tobago)
DFL	Development Finance Limited
DR	Dominican Republic
DTT	Deloitte Touche Tohmatsu Emerging Markets, Ltd.
DTTEM	Deloitte Touche Tohmatsu Emerging Markets, Ltd.
ECCB	Eastern Caribbean Commercial Bank
ECCSD	Eastern Caribbean Central Securities Depository
ECCU	Eastern Caribbean Currency Union
ECD	Eastern Caribbean Dollar
ECSE	Eastern Caribbean Securities Exchange
EGAT	Economic Growth, Agricultural and Trade
EIU	Economist Intelligence Unit
EU	European Union
FCIB	First Caribbean International Bank
FSAP	Financial Sector Assessment Program
FSC	Financial Services Commission (Jamaica)
FX	Foreign Exchange
G-10	Group of Ten Countries
GDA	Global Development Alliance
GDP	Gross Domestic Product
GNP	Gross National Product
GOJ/GoJ	Government of Jamaica
IAS	International Accounting Standards
ICA	Institute of Chartered Accountants
ICAC	Institute of Chartered Accountants of the Caribbean
IDB	Inter-American Development Bank
IFAC	International Federation of Accountants
IFRS	International Financial Review Standards (formerly IAS)
IMF	International Monetary Foundation
IOSCO	International Organization of Securities Commissions

IPO	Initial Public Offering
ISA	International Standards of Auditing
JCSD	Jamaica Central Securities Depository
JSE	Jamaica Stock Exchange
LAC	Latin America and the Caribbean
LLR	Loan Loss Ratio
MF	Micro-Finance
MFI	Micro-Finance Institution
MSE	Micro, Small, Medium Enterprises
MTEF	Medium Term Economic Framework
NBFI	Non-Bank Financial Institutions
NCB	National Commercial Bank (Dominica)
NDF	National Development Foundation
NEDCO	National Entrepreneurship Development Company Ltd.
NGO	Non-Government Organization
NPL	Non-Performing Loans
ODA	Overseas Development Agency
OECD	Organization for Economic Co-operation and Development
OECS	Organization of Eastern Caribbean States
PMG	Peer Market Group
RBC	Royal Bank of Canada
RBTT	Royal Bank of Trinidad and Tobago
RoAA	Return on Average Assets
RoAE	Return on Average Equity
ROSC	Report of Observance of Standards and Codes
RSE	Regional Stock Exchange
RSF	Revenue Stabilization Fund
RSO	Regional Strategic Objective
RTGS	Real Time Gross Settlement
RW-CAR	Risk Weighted Capital Adequacy Ratio
S&P	Standard and Poors
SEDU	Small Enterprise Development Unit
SGF	Settlement Guarantee Funds
SME	Small and Medium Enterprise
SRO	Self Regulatory Organization
SVG	St. Vincent and the Grenadines
T&T	Trinidad and Tobago
TA	Total Assets
TL	Total Loans
TT	Trinidad and Tobago
TTCD	Trinidad and Tobago Central Depository
TTD	Trinidad and Tobago Dollar
TTSE	Trinidad and Tobago Stock Exchange
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollar
WASA	Water and Sewerage Authority (Trinidad and Tobago)
WFE	World Federation of Exchanges
WOCCU	World Council of Credit Unions

## EXECUTIVE SUMMARY

This report presents findings and recommendations from a detailed assessment of the financial sectors in Barbados, Jamaica, Trinidad and the Organization of East Caribbean Countries (OECS), consisting of St. Kitts & Nevis, Antigua & Barbuda, Dominica, St. Lucia, St. Vincent & the Grenadines and Grenada.

It has been prepared by Deloitte Touche Tohmatsu Emerging Markets Ltd., (“Emerging Markets Group”) on the basis of Task Order Award 823, which was issued on 28 August 2003, under Contract No. PCE-I-00-99-00008-00. The purpose of the assessment is to assist the United States Agency for International Development (USAID) in formulating a strategy and identifying priority interventions to support development of the financial sector in the Caribbean.

### Background and Objectives

Countries in the Caribbean have long been challenged in achieving economic development. Their size, location, and vulnerability to external shocks have made it difficult to maintain stability and consistent growth. In recent years this challenge has intensified in the face of globalization, the dismantling of favorable trade arrangements, and geopolitical conflict. The confluence of these developments has resulted in sustained erosion of the economic base in a number of countries, particularly those dependent on agriculture and tourism.

Responses to this deterioration have been, on balance, positive. However, the transformations undergone by most countries are still at an early stage and they are varied in terms of progress and prospect. The key challenge for most countries is to re-configure their economies by inducing growth in new spheres of commerce and strengthen the competitiveness of viable domestic industries.

Under USAID’s Caribbean Regional Program<sup>1</sup> (CRP), maximum efforts are being made towards helping Caribbean countries to meet this economic challenge. The goal over the next several years is to improve the economic climate in the region through the creation of a more competitive and business friendly environment. One aspect of this support is to assist in the development of a resilient regional financial sector such that it can effectively support private sector growth, enhance stability, and improve the well being of the general population.

A key question for USAID in providing support for financial sector development is to identify where and how resources should be allocated to elevate the contribution of the financial sector to economic diversity and growth. To address this question, USAID has requested a financial sector assessment be conducted in the Caribbean region to address development challenges surrounding financial intermediation, in particular issues of access to and cost of credit, depth of market activity, and safeguarding the use of capital.

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<sup>1</sup> The countries grouped under the CRP comprise of the CARICOM countries, made up of the OECS, and Jamaica, Barbados and Trinidad and Tobago.

## Scope and Objectives

The assessment covers three major subject areas of financial sector activity among selected countries:

- Financial intermediation by banks and non-bank credit organizations in Trinidad, Barbados and the OECS countries
- Capital Markets in Jamaica, Trinidad, Barbados and the OECS
- Remittance activity in the OECS

For purposes of reference in this report, the group of countries covered in each area is collectively referred to as the “Focus Countries”<sup>2</sup>.

There are three clarifications worth noting on the scope of our work that help to explain the structure and nature of findings in the report. First, the assessment did not cover areas where other donors or agencies are currently focusing or are planning to focus efforts. This includes offshore banking, anti-money laundering, and corporate governance. Second, the assessment did not cover a detailed review of the real sector; although for the purpose of improving micro and small enterprise (MSE) access to finance, we have suggested a closer look into the activities and needs of enterprises in the region. Third, while government policies contribute to weaknesses in financial intermediation in a number of the Focus Countries, we have avoided delving into substantive policy analysis.

## Objectives

The primary objective of the assessment is to assist USAID in defining where to lend strategic support to facilitate financial sector development in the region. In particular, the assessment addresses strategies and potential interventions that help to:

- Improve the cost of and access to capital by the productive sector;
- Development of the financial sector in ways that will contribute to further diversification of the economy;
- Build confidence in the financial sector and/or reduce vulnerability to crises; and
- Reduce the fragmentation that exists in the sector by helping banks, non-banks, and capital market intermediaries develop into a financial “system” around which new products and services, new savings vehicles, and new markets can emerge to better serve the needs of enterprises and consumers alike.

A secondary objective is to develop a broad-based understanding of conditions in the financial sector and a reference for design of future interventions.

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<sup>2</sup> Although it is common practice to differentiate among the Focus Countries on the basis of their size – the smaller OECS countries in one group and the larger countries of Jamaica, Barbados and Trinidad and Tobago constituting the other – the key characteristics identified in this assessment and the associated recommendations are common to all of the Focus Countries. Therefore this overview discusses all of the Focus Countries as one group, with exceptions noted where appropriate.

## Our Approach

### ***Study Proceedings and Methodology***

Over the course of three months a comprehensive exercise has been carried out, which encompassed situational analysis and documentation review, international benchmarking, and discussions with a wide range of individuals and stakeholders.

In addition to the review of these elements within each of the Focus Countries, the team also reviewed the activities of other non-USAID donors in the region to determine what technical assistance programs were currently underway or being planned for the near future.

### ***Framework of the Assessment***

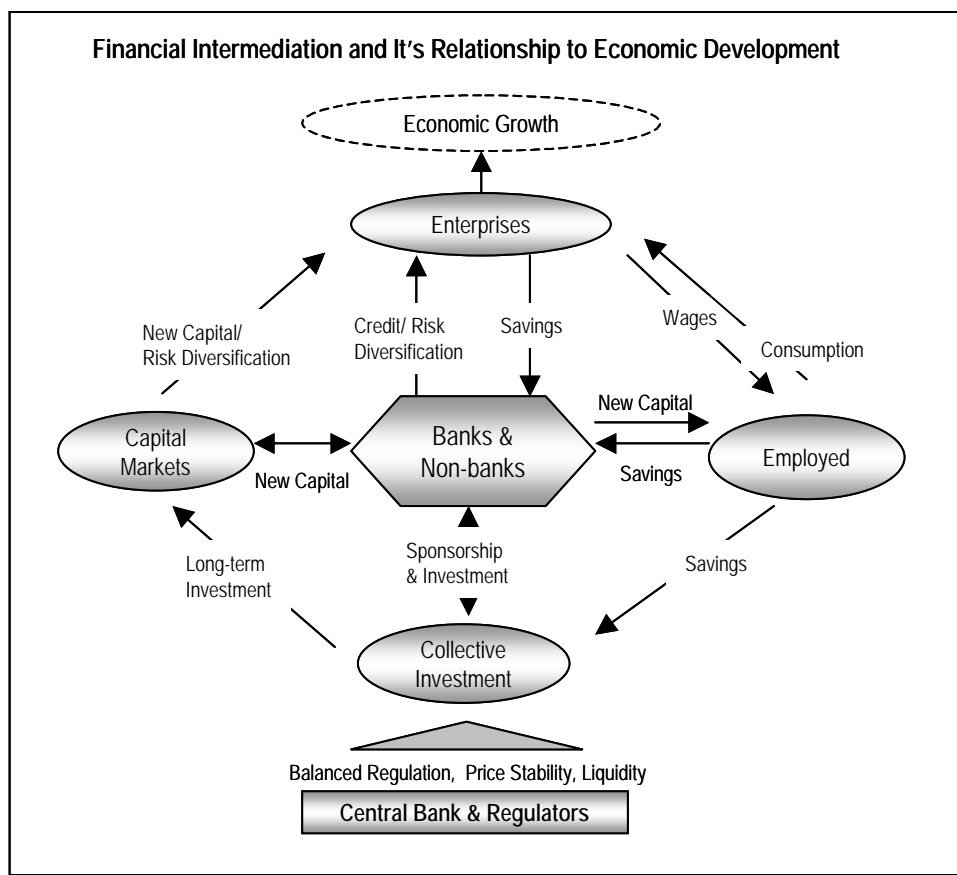
The approach adopted for the study responded to the express desire of USAID to examine the root causes of inefficient or lacking financial intermediation in the Focus Countries. This report was not intended to be a fully comprehensive inventory of financial sector activities. But rather, it is recognized that the financial sector features inter-dependency between intermediaries, policy, and infrastructure, which together determine how financial intermediation happens. Some of these interdependencies impact directly on the flow of capital to enterprises and consumers; others have an indirect impact, but are nevertheless critical to stability and confidence. While interventions with direct impact are more easily measurable against specific goals, we took the view that if a gap contributed to instability or system-wide risk exposure, it was also a priority to be addressed.

The framework for evaluating the quality of financial intermediation in the Focus Countries is based on five key functions of financial intermediation that occur between savers, users of savings, and market intermediaries in well developed financial systems. These functions are:

- Consolidation of surplus funds, or savings mobilization
- Safeguarding and protection of funds
- Efficient and timely payments processing
- Accessible and efficient financing of qualified users
- Risk diversification

Each recommendation we make in this report can be tied back to its impact on improving one or more of these five functions. In some cases the impact on intermediation is indirect, but nevertheless relevant.

The following diagram best visualizes the relationship of these functions to economic growth and employment:



## Summary Findings and Conclusions

Our analysis indicates that there are a number of important areas where technical assistance should be provided to overcome weaknesses in financial intermediation.

The assessment's primary conclusions are as follows:

- **The banking sector markets in the region are relatively vibrant and established.** However, structural conditions, fragmentation of service between the formal and informal sectors, and ownership and risk concentration present formidable challenges to raising the bar of financial intermediation to an international standard of efficiency. Some of the negative conditions are transitory and will disappear with continued reform efforts. Others, if allowed to persist, will undermine economic progress.
- **There appears to be a duality in the structure of financial intermediation by banks, depending on their ownership structure and place of origin.** Closely held private banks and foreign banks tend to cater to a narrow range of client segments, focusing on relationships based on familiarity and/or serving top-tier domestic and international clients. State-controlled banks, particularly in the OECS, are deemed to be the weakest, least market-oriented, and pose a limitation on long-term development of a number of financial systems. This duality presents a unique challenge in addressing the question of how to catalyze sector development.
- **There is a limited window of viable intervention for USAID in the banking sector at this time** There are a number of reasons for this. First, the sector is fairly well established with private

participation. Second, some of the key inefficiencies derive from government policies, such as mandatory savings, high reserve requirements, use of state banks to finance public sector expenditures, and unclear competition policies. Thirdly, CARTAC and other donors, including the IMF, have been actively involved in addressing banking sector issues. Nevertheless, there are select areas where USAID support could yield substantial benefits that strengthen the safety of funds, market-orientation of state-controlled institutions, and role of indigenous banks in MSE financing.

- **Credit unions have played an increasingly important role in financial intermediation in all of the Focus Countries, filling gaps in service to the informal sector and underserved areas.** However, unchecked growth coupled with under investment in infrastructure poses a risk to sustainability of service. High levels of bad debt and operational inefficiency pose limitations on these institutions. While lack of information on these institutions hindered our analysis of their effectiveness in financial intermediation, our on-site work indicated a wide disparity in the level of development of credit unions within and among countries. With the exception of Trinidad and Tobago, non-bank credit-related institutions (e.g. mortgage banks and finance companies) are insignificant in relation to the scale of similar services provided by banks.
- **There are high levels of liquidity in the banking system.** Some of this is from forced savings; some is from perceived lack of investment opportunities. The upshot is that banks in Trinidad and Barbados have reduced incentives to fully develop securitization. Some infrastructure does exist for this, however.
- **While the banks appear to be competing with each other and with non-bank financial institutions (NBFIs) in the consumer finance market** (including mortgages), there is markedly less competition from outside of the banking sector for corporate loans. Further development of the region's capital markets could result in a beneficial increase in this competition.
- **Important opportunities do exist on a policy level among non-bank financial institutions**, in terms of their regulation and environment for development. The role of *balanced* regulation in the development of the financial sector is an often-underemphasized aspect of donor programs.
- **The least well developed financial sector activities in all of the Focus Countries are those at the two extreme ends of the size spectrum** – the capital markets at one end and the informal and entrepreneurial sectors at the other. The underdevelopment of these activities constrains economic growth. Large and medium-sized companies are not able to access the financing they need to expand their operations efficiently, while micro enterprises may find it difficult to even get started. Heavy reliance on bank debt has increased the cost of borrowing and has led to greater leverage risk in many enterprises.
- **The capital markets of Barbados, Jamaica, the Eastern Caribbean and Trinidad & Tobago are, individually, small and illiquid.** The operational viability and financial sustainability of the individual markets is constrained by a: (i) a lack of listed issues, (ii) a lack of a variety of issues, (iii) a small number of market intermediaries and, (iv) a regionally pervasive “buy and hold” investor strategy. These problems are compounded by varying levels of non-compliance with generally accepted international standards that result in operational anomalies between individual markets. If allowed to operate under the status quo, the future viability of many of the regions' exchanges will be questionable. Distressed capital markets will undermine confidence in the regions' financial system and hinder growth of the financial sector overall.
- **There is an exceptional opportunity for USAID to take a leading role in strengthening the region's capital markets in terms of both integration and enabling environment.** Integration of stock exchanges would help to strengthen financial intermediation, improve conditions for investment, and reduce bank risk concentration.

- **At the other end of the spectrum, there is a widespread view among stakeholders that businesses in the informal and entrepreneurial sector are underdeveloped and under financed.** Deeper study is required to quantify the level of demand for MSE finance. However, among MSE finance programs currently in operation, many have shortcomings that impact on the use of finance by this segment. High unemployment and shifts in the private sector structure to service industries (from agriculture) indicate that there are opportunities for expansion of MSE financing that would have a direct and meaningful impact on the business environment.
- **Challenges in providing access to credit and lowering the cost of credit are belied by major impediments in borrower due diligence.** This stems from a lack of personal credit history information and weak financial reporting. The challenges are compounded by a weak culture for credit between lenders and borrowers, upon which trust and efficiency are based. Further challenges are present in efficiently collateralizing loans. Weaknesses in the environment for secured transactions can have a broad economic impact. It can affect the speed of bank restructuring, volume of lending by merchants to the informal and household sectors and competitiveness of businesses seeking long-term finance.
- **There is a wide range of high priority opportunities for USAID to strengthen access to and efficiency in the provision of finance to MSE's both directly and indirectly.** USAID's assistance needs to be tailored to the specific conditions of each market segment and it needs to be appropriate for the barriers that exist. It is imperative that governments and financial intermediaries in the Focus Countries pay more attention to the financing and development of the informal and entrepreneurial sectors through policy design, regulation, and creation of development incentives.
- **Remittance activity in the OECS is significant, but these capital flows are not well used as a source of savings for investment.** While a number of local banks have started to examine opportunities in this area, major gaps exist that limit the amount of remittance inflows and other private transfers to the OECS economies. Additionally, there is little in the market that provides incentives for keeping funds in accounts for savings and investment. Donor support in designing and assembling innovative consolidation programs and public private partnerships are needed to maximize impact.

## Strategic Interventions and Recommendations for USAID

The recommendations that follow from these findings have been chosen on the basis of the following criteria:

- They address financial sector gaps that affect financial intermediation in one or more of the five functional areas
- They are supported by relevant stakeholders
- They are not being addressed directly by other donors
- They do not replace private sector initiatives; although they may help to induce or overcome barriers where the private sector would otherwise respond
- There are identifiable change agents whose support for the recommendations will increase the likelihood of successful implementation
- They are aimed at increasing the ability of the financial sector to support economic growth, and are consistent with USAID's strategic objectives

In all cases, recommendations converge to support USAID strategic objectives for strengthening competitiveness and an improved business environment for enterprises. Specifically, these recommendations are aimed at increasing the efficiency of financial intermediation, while also providing access to a range of financial markets products and services. More efficient financial intermediation and market depth will lead to cheaper access to credit while also creating better conditions for foreign direct investment, job market growth, and ultimately a competitive private sector.

### ***Prioritization and Analysis of Strategic Interventions***

Key recommendations and their prioritization are summarized below. The prioritization of these recommendations is based on an analysis of their expected impact on financial intermediation, level of political will, and sequencing requirements.

High Priority – Ready for Implementation
Broad-based program to strengthen conditions for and improve access to MSE finance Support for <i>harmonization</i> of regional capital markets Support for creation of a coherent framework for NBFIs regulation and development Support for accounting reform and disclosure in OECS
High Priority – Implementation Dependent
Support for the <i>integration</i> of regional capital markets Support for the development of non-bank debt markets Support for strengthening of deposit protection in OECS Support for the development of investor protection schemes Support for strengthening of public governance and market-orientation of state-controlled banks
Constructive – Ready for Implementation
Support for development of crises contingency frameworks Support to strengthen Jamaican securities markets Support for development of community-based programs that help to leverage remittance flow for long-term investment Support for the widespread implementation of an international remittance network

A summary of further analysis of the recommendations is provided on the following pages.

### ***Recommendations for the Financial Sector***

#### **Broad-based Assistance to Strengthen Conditions for Improving Access to and Use of Formal Finance by MSE's**

USAID has a significant history of addressing MSE finance development around the world, in particular through multifaceted projects that simultaneously address a range of weaknesses. As one of the leading donors in these types of interventions, we recommend that USAID develop a broad-based program to strengthen the environment for MSE finance. Key elements of this program should include<sup>3</sup>:

<sup>3</sup> While our aim for these recommendations is on improving financial intermediation and the economic impact of the financial sector, we did not address the potential use of large direct subsidies from USAID, as for example, that might be provided in an SME credit program, or a guarantee program. These programs, if designed right, can have a substantial impact on job

- A comprehensive demand assessment/market survey of MSE finance. Expansion of micro finance outreach
- Support for the development of domestic and regional credit bureaus
- Assistance to indigenous institutions in developing business models targeted at SME banking
- Reform and upgrading of collateral registration system and environments for secured transactions
- Generation and dissemination of market information on MSE activities

### **Development of a Coherent Framework for Regulation of all NBFIs (Non-bank Financial Institutions)**

Efforts to create integrated regulators in the Focus Countries have focused more on administrative and process issues than on framework and policy. USAID can achieve a marked impact on financial sector development by working with governments and institutions on developing the *right* types of regulatory structures so that NBFIs can develop and attract investment. Such assistance should not be under-rated in its potential impact on sector development. This can be seen in the efforts of leading regulators around the world who have initiated sweeping regulatory reforms to eliminate barriers to safe and sound growth of their domestic financial systems.<sup>4</sup> High priority areas that should be incorporated into an intervention include the following:

- Support for the development of *integrated* regulatory frameworks (in contrast to the organizational integration that is currently being undertaken)
- Support for strengthening of credit union supervision and regulation in OECS
- Development of interventions that provide broad-based support for the development and strengthening of insurance regulation
- Special assistance to financial sector policy makers on structural conditions within and among target countries and sector-wide policies

### **Technical Assistance to OECS Countries in the Evaluation, Design and Implementation of Deposit Protection Mechanisms**

The lack of explicit, limited deposit protection in the OECS is inefficient. It represents a barrier to the integration of financial markets across the region; it hinders savings mobilization; and it fosters uncertainty among deposits since they have no express assurance that the governments will protect their depositors if a bank fails.

While express, limited deposit protection schemes have their own pitfalls, they are generally regarded as a better alternative to open-ended state guarantees and can have a strengthening effect on local banking systems. We recommend that USAID consider providing support to OECS countries in the evaluation,

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creation and in building the experience of local institutions. The results of a detailed SME finance demand should justify the use of a credit intervention.

<sup>4</sup> This includes regulators in Canada, Australia and the United Kingdom, all of whom have noted “industry development” as one of their officially mandated objectives.

design, and, if feasible, implementation of deposit *protection* arrangements for depositors of domestic banks. Deposit protection is not limited to deposit insurance: it can include other forms of protection, such as by granting deposits priority status in insolvency proceedings or other means.

### **Support for the Development and Implementation of Contingency Planning Frameworks that Allow Countries to Respond Effectively to Financial Shocks and Crises**

The extent of risk concentrations across the regional economies, and the inherent vulnerabilities of the small financial systems to external shocks, underscores the need for a crises contingency plan that will set out policies and actions in the event any or all of the island economies face a crises. USAID should play a role in assisting in the design of an overall contingency plan that set out policies and procedures to be adopted by the relevant authority to: address the safety and soundness of the financial system; identify potential liquidity, solvency and management issues early; anticipate and resolve policy issues; define and communicate viable, credible plans, avoiding crisis management; segment potentially troubled institutions according to areas of risk and structural supports.

### **Support for Strengthening the Public Governance and Market-oriented Influence of Indigenous State-controlled Banks**

Reform of state-controlled banks, and reduction in the influence of central government on bank lending, are perhaps two of the most challenging issues facing several of the countries. Weak and improperly governed banks are a counterweight to development that is a systemic threat to market confidence in general. Our recommendations address the following:

- Assistance in the restructuring and workout of state-controlled banks slated for privatization
- Assistance in the development of alternative resolution programs for distressed debtors
- Assist host governments in creating adequate corporate governance processes for *state-controlled* institutions

### **Recommendations for Capital Markets**

The recommendations for capital markets focus on two areas. One set of recommendations concern the regional integration of the securities markets, to enable them to achieve the size and economies of scale necessary to play a significant role in financing the regions larger companies. The other set of recommendations address strengthening of the environment for capital market transactions.

### **Technical Assistance and Advocacy for the Harmonization and Integration of the Regional Securities Exchanges**

The governments of the Focus Countries fully recognize that the key to addressing size-related inefficiency challenges lies in greater intra-regional financial activity. However, in spite of various efforts to achieve integration, there is no obvious change agent to propel a regional securities exchange forward. Drawing from its strengths in exchange development and its comparative advantages in being able to fund sustainable assistance, USAID could play an instrumental role in helping to facilitate the harmonization, regionalization and eventual integration of exchanges throughout the region. The steps required to create the virtual regional securities exchange fall into two categories, or areas, where USAID should seek to provide support:

- **Support for the four existing exchanges to harmonize their activities and achieve uniform compliance with international standards<sup>5</sup>:** Steps required to achieve harmonization of individual exchanges, include: harmonization of trading platforms; harmonization of clearing and settlement software and procedures, including settlement cycles; establishment of settlement guarantee funds; establishment of contingency funds<sup>6</sup>; establishment of compensation funds<sup>7</sup>; development of the ability of each country's Central Securities Depositories (CSDs) to clear and settle in multi-currencies; development of securities borrowing and lending program; implementation of numerous specific regulatory reforms to achieve consistency with international standards (Listed in Annex B).
- **Support for the development of an electronic, integrated, regional securities exchange with remote access for intermediaries:** USAID support in this area should focus on: mediating among counterparts and helping them to achieve agreement on the establishment of a virtual exchange; assistance in technology review, including determination of the necessary hardware and software for an integrated exchange; support for the creation of a regional regulatory body; and establishing a membership structure.

### Technical Assistance for the Development and Harmonization of Investor Protection Measures

The majority of countries do not have adequate investor protection schemes in place to meet international standards. Efforts to strengthen protection of investors should center primarily on three areas: more stringent setting and enforcement of disclosure requirements of publicly traded securities; tougher regulation of the market conduct, promises, and undertakings of financial intermediaries; and statutory requirements for the creation of investor protection schemes. USAID can play a very specific role in helping countries design and implement investor protection funds.

### Support to Strengthening of Information Disclosure and Financial Reporting in the OECS

There is a clear and relevant need to implement accounting reform in the OECS. USAID can play an important role in extending accounting reform to the OECS. Efforts should focus on: adoption of international accounting and auditing standards; support for the development of laws and regulations for better disclosure; support for building legal framework and institutions to comply with the OECD principles of corporate governance. USAID has comparative strengths in this type of reform through the existence of the Global Development Alliance and a substantial history of support to developing countries in the area.

### Targeted Support for the Development of Debt and Money Markets

While broad-based support for financial market deepening may not be effective without first achieving the standards compliance and harmonization that is noted above, there are at least two near-term needs that USAID could address that would support both enhanced capacity for financial intermediation and eventual growth of non-bank debt.

<sup>5</sup> Detailed recommendations, including recommendations specific to the individual exchanges, are discussed in Appendix 1.

<sup>6</sup> Such a fund currently exists only in Trinidad and Tobago.

<sup>7</sup> Such a fund currently exists only in Jamaica.

- Provide technical assistance to the regional depositories to assess the operational and financial practicality of enhancing settlement systems or replacing settlement systems to accommodate fixed income transactions
- Support for the successful development and launch of a regional rating agency; either through direct support to a private sector owner, or through the creation of a pilot institute that would incubate a rating service.

#### **Targeted Technical Assistance to Jamaica for the Strengthening of its Market Infrastructure and Supporting Organizations.**

Jamaica is a strategically important country for USAID assistance; it is an economic force in the region; and it has a tenuous financial position that could threaten stability if market diversity is not achieved and structural reforms are not put into place. During the course of our review of the Jamaican capital market, a number of critical needs were identified for which USAID could lend support through both long and short-term interventions. These include:

- Assistance to the Jamaican Stock Exchange Specialty Market in achieving business viability
- Assistance to the Jamaican Central Securities Depository in achieving viability and in developing its role as a debt registrar
- Assistance in the development of a mark-to-market valuation service to accurately report and monitor the build up of risk in the system from long-term repos
- Legislative support for the development of mutual funds

#### **Recommendations for Remittances**

There are at least two ways to enhance the economic development impact of remittances. One is to introduce interventions that reduce the cost of remittances. In this way more funds are available to the end-user. A second approach is to develop ways to utilize some of the remittance proceeds for development purposes. There is a role for USAID assistance in addressing both of these.

#### **Support for the Development of Community-based Programs that Help to Leverage Remittance Flows for Long-term Investment**

USAID could work with local institutions and other donors to develop strategic links or public-private partnerships that promote the consolidation of remittance flows for long-term community investment. (e.g., housing, health clinics, schools, roads, water). Such programs may enable the intermediary to attract more remittance clients who wish to support the development effort (thus contributing to further economies of scale), as well as providing remitters an opportunity to contribute. One version that has been proposed, and is apparently working in some parts of Mexico, has been the use of matching funds through hometown or national associations to stimulate investment in housing, infrastructure, and other community needs.<sup>8</sup>

<sup>8</sup> As an example, in Zacatecas, Mexico, the state provides a 3-1 financing ratio for roads, schools, churches, water systems, and parks. See "Making the most of an exodus", *The Economist*, August 2, 2003.

### **Support for the Widespread Implementation of an International Remittance Network in the OECS**

Many credit unions in the OECS lack the capacity and means to handle remittances. USAID could lend direct technical assistance and grant support for the implementation of the IRnet wire transfer service. The network enables credit unions to implement money transfers at approximately one third the transaction cost of the money transfer companies

Participation in the network would enable credit unions to lower the cost of money transfers; provide a wider range of payment services to their clients; and ultimately increase the number of clients and, correspondingly, funding resources.

## Summary and Prioritization of Key Recommendations By Area

Strategic Intervention & Recommendations	Key Gap/ Vulnerability	Potential Strategic Impact	Political Will/ Change Agent	Priority Sequencing	USAID Justification	Indicative Results
<b>FINANCIAL SECTOR – BANKS/NBFI</b>						
<b>Strengthen conditions for and improve access to MSE finance</b>	Significant shortcomings in existing MSE finance programs. No formal measurement of demand for finance.	Greater capital allocation for MSE development will lead to more economic diversity, growth, and resilience in employment base – all critical goals for the target countries.	Strong/Banks, credit unions, business promotion policymakers.	High – immediately implementable	Leader in the design and implementation of integrated, multiple intervention MSE finance and development programs. Piecemeal reform will not be effective in addressing urgent needs.	<ul style="list-style-type: none"> <li>Increased capacity for MSE financing.</li> <li>More efficient and accurate risk screening; lower costs for financing.</li> <li>Detailed understanding of demand for finance upon which future interventions and business promotion policies can be based.</li> <li>Improvements in the type and suitability of financing products made available to MSE's.</li> </ul>
<b>Support for development of a coherent framework for NBFI regulation</b>	Piecemeal/unbalanced regulation of institutions poses a threat to efficient intermediation, confidence, and development.	Appropriate calibration of regulation will support safe and sound development across the sector; it will reduce regulatory arbitrage; over time it will improve competition and lower costs.	Unclear/Financial regulators, CCCU, CARTAC, ECCB and SRO's.	High – immediately implementable	Work of other donors is spotty and intermittent. Work requires sizeable commitment and sector-wide approach. USAID has a substantial history of regulatory strengthening and a more recent history in sector-wide programs.	<ul style="list-style-type: none"> <li>Reduced systemic risks.</li> <li>More even development of NBFIs – and banks.</li> <li>Creates a platform for inter-regional cooperation and risk-sharing (e.g. among insurance companies).</li> </ul>

Strategic Intervention & Recommendations	Key Gap/ Vulnerability	Potential Strategic Impact	Political Will/ Change Agent	Priority Sequencing	USAID Justification	Indicative Results
Support for strengthening of deposit protection in OECS	Lack of deposit protection undermines confidence and savings mobilization. It weakens the positive effects of market discipline on resource allocation. Government's impose high reserve requirements and forced savings to serve as protection. This is inefficient and imposes a substantial cost burden on system.	Well-designed deposit protection in OECS will facilitate savings mobilization, lead to closer harmonization with other countries in region, and strengthen market discipline.	Weak/ECCB, Banks, home country regulators.	High – implementation dependent on support from ECCB (advocacy needed)	No apparent work being done in this area and USAID has a substantial history in addressing protection arrangements. The impact on resource allocation can be very undermining.	<ul style="list-style-type: none"> <li>• Creation of an explicit deposit protection scheme for the OECS that limits govt. assurances and strengthens market discipline</li> <li>• Greater competition for large institutional deposits;</li> <li>• More and lower costs of savings</li> <li>• More consumer deposits flowing into the OECS.</li> <li>• Reduced reliance on forced savings as a means of protection</li> </ul>
Support for development of crises contingency frameworks	High vulnerability to financial shocks. Lack of mechanisms for coordinating responses to shocks within and among target countries.	Impact on intermediation is indirect, but will lead to a more stable and measured response to shocks. This in turn can reduce uncertainty and strengthen the investment and business climate.	Strong/ Financial regulators, central banks, ministries of finance across the region.	Constructive – immediately implementable.	No apparent work being done in this area for the financial sector.	<ul style="list-style-type: none"> <li>• Development of a concise strategy and decision-making framework for dealing with distressed institutions</li> <li>• Risk mapping to show where vulnerabilities exist in the sector</li> <li>• More coordination and communication among countries when shocks occur</li> </ul>
Support for strengthening of public governance and market-orientation of state-controlled banks	State-controlled banks are weak and inefficient in a number of countries. Sizeable public debt overhang serves as a burden on financial intermediation and resource allocation. Weak public sector governance raises questions of transparency and accountability.	As state-banks are the main pillar of some financial systems, improved governance and restructuring will lead to better resource allocation, more confidence in the financial system, and more efficiency.	Unclear/ State banks and home country governments.	High Priority – implementation dependent on support from home country governments.	USAID has a substantial history in supporting reforms to corporate governance and bank restructuring. OECS countries stand to benefit the most from interventions, which is where financial sector development is the weakest and donor support is the least.	<ul style="list-style-type: none"> <li>• Improved governance and public accountability of state-run institutions</li> <li>• Improvements in the efficiency and operation of state-run institutions</li> <li>• More balance resource allocation between public and private sector projects</li> </ul>

Strategic Intervention & Recommendations	Key Gap/ Vulnerability	Potential Strategic Impact	Political Will/ Change Agent	Priority Sequencing	USAID Justification	Indicative Results
<b>CAPITAL MARKETS</b>						
<b>Support for harmonization and integration of regional securities exchanges</b>  <i>Part I: Support for harmonization of operations and regulations</i>  <i>Part II: Support for implementation of a virtual securities exchange</i>	<p>Local capital markets are weak and under-developed. They lack scale and depth and do not provide a potential source of capital for the majority of enterprises. The exchanges are not sufficiently developed in order to provide adequate risk regional diversification, which adds to the risk concentration problem faced by nearly every country.</p> <p>Anomalies between markets and lack of full compliance with standards serve as a barrier to integration. There is no neutral leadership to facilitate integration.</p>	<p>Harmonization of standards and regulations will set the stage for integration. This first step will improve the credibility and attractiveness of the markets to investors.</p> <p>Some form of integration and cooperation is a key requirement to both ensure the viability of the regions exchanges and create a virtuous cycle of new sources of capital and savings, grater. The creation of a virtual regional exchange is deemed most politically acceptable.</p>	Strong, but un-aligned among target countries /securities exchanges, ECCB market intermediaries and regulators.	High – Part I immediately implementable; Part II will have no feasibility without Part I achieved.	USAID is a leading donor in capital markets reform, in particular the development of exchanges. It has the scale of resource and reach to be an important catalyst.	<ul style="list-style-type: none"> <li>• Comparability of the existing securities exchanges in terms of trading systems, settlement and clearance, and compliance with international standards</li> <li>• An increase in the number of cross-listings</li> <li>• Regional consensus on the creation of a virtual integrated exchange</li> <li>• Successful setup and operation of a virtual integrated exchange</li> <li>• An absolute increase in the number of listings in the region</li> <li>• Emergence of new risk diversifying products</li> <li>• Reduction in the overall level of debt across the region</li> </ul>
<b>Support for accounting reform and disclosure in OECS</b>	Application of accounting reforms is uneven throughout the region. The OECS is the least advanced in adopting international standards of reporting and disclosure.	The integration of securities markets in the region and the success of the newly formed East Caribbean market rest in part on adequate disclosure and reporting. Improvements in transparency and disclosure are key fundamental first steps for improving financial intermediation and capital access.	Unclear /ICAC, local accounting professionals, IFAC.	High – immediately implementable	USAID has a substantial history in this type of reform and a comparative advantage in the application of interventions through the Global Development Alliance. The GDA has been used to leverage public private partnerships involving international accounting institutes and local accounting firms to strengthen accounting standards and develop certification regimes.	<ul style="list-style-type: none"> <li>• Widespread adoption of international accounting standards</li> <li>• Improved laws on disclosure</li> <li>• Improved legal frameworks promoting compliance with OECD principles of disclosure and governance</li> </ul>

Strategic Intervention & Recommendations	Key Gap/ Vulnerability	Potential Strategic Impact	Political Will/ Change Agent	Priority Sequencing	USAID Justification	Indicative Results
<b>Support for the development of investor protection schemes</b>	Lack of formal protections for small investors hinders retail market development. Lack of protections make investors vulnerable to abuse, which can undermine market confidence. History is fraught with market collapses resulting from abusive practices going out of control.	Strengthened protection for investors will help to build a base of confidence for retail growth of the securities business.	Mixed – local exchanges and their SROs and the newly consolidated regulatory agencies are key.	High – implementation dependent on buy-in from exchanges.	USAID has a substantive history on helping local capital markets reform. It has access to a wide range capital markets specialists who can ably advise on how to design protection mechanisms.	<ul style="list-style-type: none"> <li>• Safety of small investors funds</li> </ul>
<b>Support for the development of non-bank debt markets</b>	The market infrastructure for non-bank debt is undeveloped. There have been efforts to establish a regional rating agency, but the likely success of those efforts is unclear. Trading systems in Barbados, Jamaica and Trinidad also lack some capacity to adequately settle fixed income transactions.	An improved infrastructure for fixed income transaction origination and settlement would support growth of primary and secondary markets for non-bank debt. Growth in this market would boost financial intermediation by bringing new users and sources of capital together; with an intended effect of lowering the cost of debt.	Mixed /banks who dominate the market for corporate finance/merchant banking, local exchanges.	High – implementation should be conditioned on success of efforts by the private sector to obtain market buy in for rating agency.	Very little, if any, support seems to have been given to the development of market infrastructure for non-bank debt. USAID has been a leader in promoting the development of non-bank debt market in various parts of the world. To the extent the private sector faces barriers in building this infrastructure, USAID can play an instrumental role in facilitating market development.	<ul style="list-style-type: none"> <li>• Improvements to exchange systems that allow accurate and reliable settlement of fixed income transactions</li> <li>• The creation of a credible and independent regional rating agency</li> <li>• Lower borrowing costs</li> <li>• Growth in public listings of corporate bonds</li> </ul>
<b>Support to strengthen Jamaican securities markets</b>	The JSE is under-developed and exposed by a weak infrastructure. Continued weakness and a loss of confidence could result in the failure of the exchange and deterioration in the confidence in financial markets throughout the region.	Strengthening of the JSE and its related institutions will help to create a robust market environment. The impact of the recommendations on financial intermediation is indirect.	Strong /JSE, JCSD, market intermediaries.	Constructive – immediately implementable	Jamaica is a strategically important country for USAID assistance. USAID has a substantial history of lending technical support capital markets intermediaries and exchanges.	<ul style="list-style-type: none"> <li>• An improved business profile for the JSE</li> <li>• An improved business profile for JCSD</li> <li>• Increased capacity of JCSD to provide bondholder registrar services and mark-to-market valuation services to the marketplace</li> <li>• An improved environment for mutual funds and growth in the number of mutual fund registrations</li> </ul>

Strategic Intervention & Recommendations	Key Gap/ Vulnerability	Potential Strategic Impact	Political Will/ Change Agent	Priority Sequencing	USAID Justification	Indicative Results
<b>REMITTANCES</b>						
<b>Support for development of community-based programs that help to leverage remittance flow for long-term investment</b>	Remittances to the OECS are relatively significant, but they are not well used as a source of savings and investment. The consolidation of remittances is not achieved in any meaningful way.	Direct impact on financial intermediation. Consolidation and use of remittances for investment will represent an increase in investment over consumption. If allocated efficiently, the funds would be expected to contribute to economic growth.	Unclear/banks, hometown associations, Western Union.	Constructive – immediately implementable.	USAID can play an important intermediary role in helping to forge links among local communities, remittance handlers, and remittance originators. It has a comparative advantage in helping to forge public private partnerships	<ul style="list-style-type: none"> <li>• Increased retention and use of remittances for long-term investment</li> <li>• Greater coordination among the target countries in the collection and security of remittances</li> <li>• Greater coordination between local communities and overseas nationals</li> <li>• More widespread donor involvement in developing programs to facilitate productive uses of remittances</li> </ul>
<b>Support for the widespread implementation of an international remittance network</b>	The cost of processing and handling remittances is high. In the OECS the infrastructure is particularly weak. There is poor access to remittance handlers in some parts of the region.	More competition among remittance handlers should lead to lower costs and better access to consumers.	Unclear/CCCU, WOCCU	Constructive - but dependent on at least co-investment by credit unions.	<p>Most credit unions are in need of a substantial subsidy and technical assistance to build capacity for handling remittances.</p> <p>USAID has a substantial history of providing support to credit unions; it has partnership links with WOCCU; and it can facilitate coordination across the region.</p>	<ul style="list-style-type: none"> <li>• Increase capacity of credit unions to handle remittances in under-served areas</li> <li>• Increased competition in receiving and handling remittances</li> <li>• Lower costs of remittance handling</li> </ul>

# INTRODUCTION

## Background

Countries in the Caribbean have long been challenged in achieving economic development. Their size, location, and vulnerability to external shocks have made it difficult to maintain stability and consistent growth. In recent years this challenge has intensified in the face of globalization, the dismantling of favorable trade arrangements, and geopolitical conflict. The confluence of these developments has resulted in sustained erosion of the economic base in a number of countries, particularly those dependent on agriculture and tourism. There are several important trends affecting Caribbean countries today:

- **Growth slowdown:** All of the Focus Countries except for Trinidad and Tobago have suffered from economic problems in 2001 and/or 2002 due to a combination of factors including the global economic slowdown; reduced tourism following September 11, 2001; a drought in some OECS countries; tropical storm Lili of September 2002 that also affected some OECS countries; and, for all of the Focus Countries except Trinidad and Tobago and Antigua and Barbuda, the ongoing adjustment of their economies to the declining importance of agriculture.
- **High poverty and unemployment levels:** Although the slowdown in economic growth has exacerbated the situation, the high levels of poverty and unemployment in the topic countries is not a temporary phenomenon, with even Trinidad and Tobago suffering from an unemployment rate (2001) of 10.8 percent and a poverty rate of 21.2 percent.
- **Weak government finances in the OECS:** Partly because of this growth slowdown, government finances in a number of OECS countries in particular have worsened. For those countries with large state-controlled banks, this worsening is reflected in the financial condition of those banks as well: they have significant loan exposure to state-supported projects as well as holdings of government securities.

In order to meet the challenges over the near to mid term, the region faces several imperatives which it must address in order to rekindle growth. It must ensure that its export prospects are improved through the expansion in its competitive capabilities. The encouragement of foreign direct investment is key to economic success while governments focus on tight management of fiscal accounts supported by sound monetary policies.

Responses to this deterioration have been, on balance, positive. Governments to an extent instituted some structural reforms. Platforms for economic cooperation and technical assistance have been formed. Local and foreign institutions and enterprises have expanded or consolidated their operations, albeit selectively. However, the transformations undergone by most countries are still at an early stage and they are varied in terms of progress and prospect. The key challenge for most countries is to re-configure their economies by inducing growth in new spheres of commerce and strengthen the competitiveness of more secure domestic industries.

Under USAID's Caribbean Regional Program<sup>9</sup> (CRP), maximum efforts are being made towards helping Caribbean countries to meet this economic challenge. The goal over the next several years is to improve the business and economic climate in the region through the creation of a more competitive and business friendly environment. The first Strategic Objective (RSO 1) under the CRP "Improved Business Environment to Meet International Standards" was developed to ensure that firms within the identified

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<sup>9</sup> The countries grouped under the CRP comprise of the CARICOM countries, made up of the OECS, and Jamaica, Barbados and Trinidad and Tobago.

countries are in compliance with international standards, and are able to deliver goods and services in accordance to those standards.

One aspect of this support is to assist in the development of a resilient regional financial sector such that it can effectively support private sector growth, enhance stability, and improve the well being of the general population. A number of other constraints have created a situation where the access to credit has impeded growth across the board. The lack of credit, in addition to burdensome collateral requirements, has hampered trade on a competitive scale and growth in a number of sectors. This has affected all segments of the financial sector, including the capital markets, which have been stunted by barriers to entry as well as fragmentation and non-cooperation. There is also a need to improve regulation and supervision that must accompany improvements in the structure of the financial markets. This does not however imply over regulation, but rather, incentives for appropriate market behavior need to be put in place to ensure a high quality of processes and institutions, through self-regulation. In addition, recently the remittance market has been an increasing source of funds for small businesses and households. Organized information on the regional growth of this sector as well as its regional implications is lacking.

A key question for USAID in providing support for financial sector development is to identify where and how resources should be allocated to elevate the contribution of the financial sector to economic diversity and growth. To address this question, USAID has requested a financial sector assessment be conducted in the Caribbean region to address development challenges surrounding financial intermediation, in particular issues of access to and cost of credit, depth of market activity, and safeguarding and use of capital.

## Scope and Objectives

### Scope

Deloitte Touche Tohmatsu Emerging Markets Limited (DTTEM) was engaged on 28 August 2003 to undertake this financial sector assessment of selected Caribbean countries (the Focus Countries<sup>10</sup>) to assist USAID in identifying and prioritizing potential interventions. The study was conducted over a period of three months.

The assessment covers three major subject areas of financial sector activity among selected countries:

- Financial intermediation by banks and non-bank credit organizations in Trinidad, Barbados and the OECS countries:
- Capital Markets in Jamaica, Trinidad, Barbados and the OECS
- Remittance activity in the OECS

### FINANCIAL SECTOR REVIEW (BANKS AND NON-BANK CREDIT INSTITUTIONS)

The Financial Sector Assessment included a review of the composition and structure of the financial sector, the supporting infrastructure, the application of prudential norms, and the level of intermediation that is currently taking place in the system. It addressed gaps and vulnerabilities for each area, strengths and weaknesses of the regions financial systems, and areas of potential growth region-wide. The study focused on banks and non-bank intermediaries.

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<sup>10</sup> The Focus Countries are Barbados, Trinidad and Tobago, Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Jamaica (the latter for capital markets only).

## **CAPITAL MARKETS ASSESSMENT**

The Capital Markets Assessment analyzed the four separate markets that currently exist in the Caribbean region. Attempts in the past to harmonize these markets and make them operate more efficiently have unfortunately not been successful – this study was intended to identify the operational viability and financial sustainability of the individual markets, as well as make recommendations on the best course of action for more efficiency and integration regionally. Technological innovations to facilitate cross-border transactions and clearing and settlement were also reviewed.

## **REMITTANCES ASSESSMENT**

The Remittance Sector Assessment sought to identify problems that add to transactions costs, and to make recommendations on how incentives can be more favorably structured to increase service levels, bring down costs, and generally accommodate the growing flow of remittances. As an extension of that effort, the focus of this study is to make recommendations on how to encourage the use of remittance inflows increasingly for investment purposes.

### ***Clarifications on the Scope***

There are three clarifications worth noting about the scope of our work. They help to explain the structure and nature of findings in the report.

First, our assessment, by design, did not cover certain technical areas. Anti-money laundering, offshore banking, and corporate governance were left out of the analysis. Other areas that we were aware of being covered or targeted for coverage by other donors were also excluded from detailed review.

Second, while our focus was on financial sector interventions that will lead to an improved economic environment, they are only part of the development puzzle. Our assessment did not cover the real sector. Issues in the real sector, such as whether enterprises are growing to maximum capacity, whether they have the skills or will to grow, what their response time is to new economic opportunity, how changes in the structure of the private sector are affecting real demand, etc. all clearly have bearing on the interpretation of data that underlies the assessment. These questions and others are also significant for understanding where on the continuum of modernization the financial sector needs to be to optimally support enterprise development. The financial sector needs to respond to the *state* of the market.

Finally, we have avoided delving into substantive policy issues. In a number of countries, ill-conceived government policies contribute to weaknesses in financial intermediation as much, or more so, than any single factor that we examined. While USAID can play an important role in strengthening policy-making processes and consensus building, policymaking is a role for the Focus Countries' government.

### ***Assessment Objectives***

The primary objective of the assessment is to assist USAID in defining where to lend strategic support to the financial sector development in the region. In particular, the assessment addresses strategies and potential interventions that help to:

- Improve the cost of and access to capital by the productive sector;
- Develop the financial sector in ways that will contribute to further diversification of the economy;
- Build confidence in the financial system and/or reduce vulnerability to financial crises; and
- Reduce the fragmentation that exists in the sector by helping banks, non-banks, and capital market intermediaries to develop into a financial “system” around which new products and services, new savings vehicles, and new markets can emerge to better serve the needs of enterprises and consumers alike.

A secondary objective is to develop a broad-based understanding of conditions in the financial sector as a reference for design of future interventions.

## **Our Approach**

### ***Work Plan and Methodology***

Over the course of three months a comprehensive exercise was carried out, which encompassed situational analysis and documentation review, international benchmarking, and discussions with a wide range of individuals and stakeholders.

The team conducted preparatory research and data analysis prior to mobilization. The greater part of the research was derived from sources such as the World Bank, IMF, central banks, commercial banks, securities and exchange commissions, and other regional donor agencies working in the region. The Deloitte Emerging Markets Team then traveled to the region to conduct its analysis and research for each respective technical area.

Relevant data tables containing economic indicators, financial sector indicators and economic trends have been supplied in this report for all three technical reviews. Extensive in-country interviews were held and the findings and results of these meetings were incorporated into the observations. In addition, the interviewees provided invaluable insight into the specific situations of many of the markets the Team analyzed. They were also key to getting feedback on both the gaps/vulnerabilities, as well as for areas of potential recommended intervention. After all the findings were synthesized and analyzed, the major gaps and vulnerabilities for each technical area were identified. These gaps and vulnerabilities led to the identification of areas in which recommendations for possible interventions could take place.

In all cases, recommendations converge to support USAID strategic objectives for strengthening competitiveness and an improved business environment for enterprises. Specifically, these recommendations are aimed at increasing the efficiency of financial intermediation, while also providing access to a range of financial markets products and services. More efficient financial intermediation and market depth will lead to cheaper access to credit while also creating better conditions for foreign direct investment, job market growth, and ultimately a competitive private sector.

### ***Framework of the Assessment***

The approach adopted for the study responded to the express desire of USAID to examine the root causes of inefficient or lacking financial intermediation in the Focus Countries. It was not intended to be a stock take of everything that could be improved, however major or remotely related to financial sector activity.

We recognize that there are numerous inter-dependencies among financial sector actors and the infrastructure that determines how financial intermediation happens. Some of these impact directly on the flow of capital to enterprises and consumers; others have an indirect impact, but are nevertheless critical to stability and confidence.

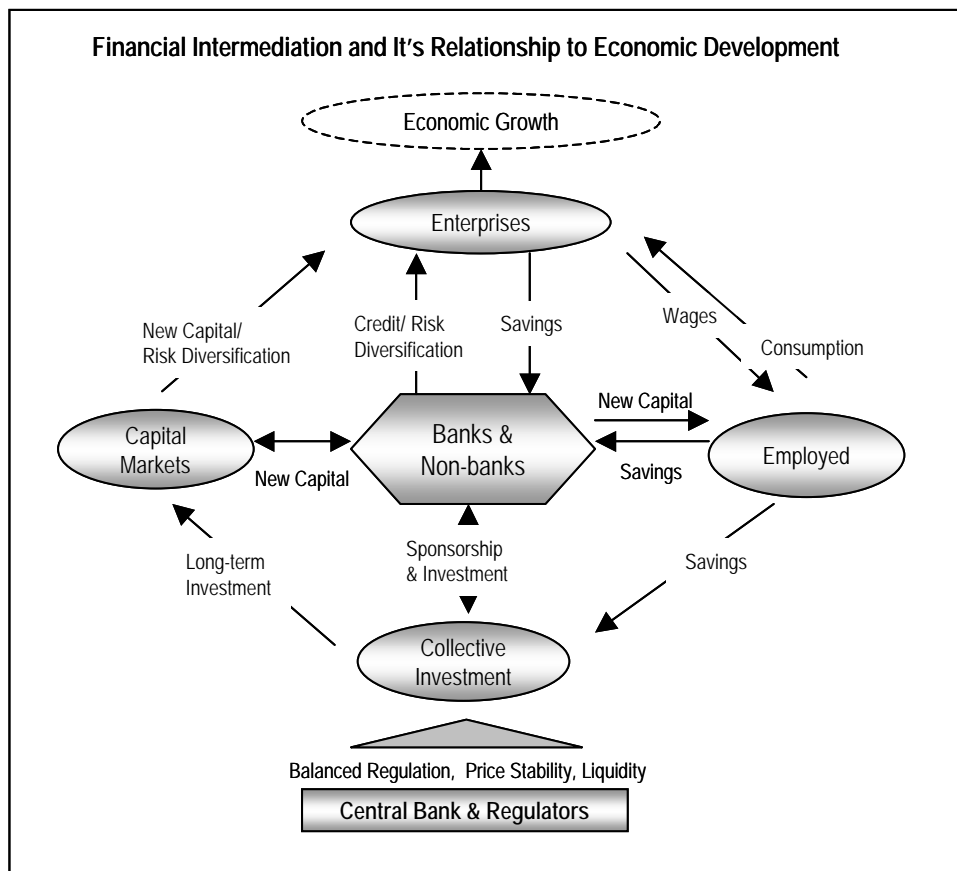
The framework for evaluating the quality of financial intermediation in the Focus Countries is based on five key functions of financial intermediation that occur between savers, users of savings, and market intermediaries in well developed financial systems. These functions are:

- Consolidation of surplus funds, or savings mobilization
- Safeguarding and protection of funds
- Efficient and timely payments processing
- Accessible and efficient financing of qualified users

- Risk diversification

Each recommendation we make in this report can be tied back to its impact on improving these five functions. In some cases the dependence is secondary or tertiary, but nevertheless significant.

The following diagram best visualizes the relationship of these functions to economic growth and employment:



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## Organization of Report

This main report is organized along the lines of the Terms of Reference as follows:

Report Section	Section Title
I	The Financial Sector (Banks & Non-Bank Credit Institutions)
II	Capital Markets Assessment of Barbados, Jamaica, Trinidad and East Caribbean Securities Exchange
III	Remittances in the OECS

Each section contains a summary of our analysis and findings, followed by a discussion of key gaps and vulnerabilities. A detailed discussion of recommendations for strategic interventions follows the gap analysis.

Detailed reports and analysis from the team's review are contained in a set of annexes. The information in these annexes edifies the findings of each main section and includes additional information that forms a useful reference.

Annex	Contents
A: Financial Sector Assessment	Provides charts and comparative data supporting the financial sector assessment. It includes separate country analyses for each of the Focus Countries, including each individual OECS country.
B: Capital Markets Assessment	Provides comparative information among the Focus Countries and other like markets in the world. It includes a detailed review of each of four main exchanges and a detailed assessment of compliance with international standards.
C: Remittances Assessment	Provides a detail remittance study, including data and analysis on remittance activities in the region.

## THE FINANCIAL SECTOR

This Financial Sector Assessment provides an overview of the banks and non-bank credit organizations in the Focus Countries. It examines the structure of the sector, intermediaries, regulation, environmental conditions, and key elements of the process of financial intermediation. The assessment is organized as follows:

- Financial sector composition and structure
- Financial sector infrastructure
- Financial sector development based prudential norms
- Financial sector intermediation indicators
- Economic factors/indicators.
- Summary of Key Gaps and Vulnerabilities

More information and data covering this assessment is provided in **Annex A**.

The following summarizes our main findings from the analysis of bank and non-banks in the “Focus Countries” according to key parameters provided in the Terms of Reference.

### Financial Sector Composition and Structure

#### ***Overview of Banks***

##### **SUMMARY**

There are five key characteristics to note that are relevant to the structure and composition of the banking sector in the Focus Countries:

- First, banks dominate the non-bank credit organizations in terms of total assets.
- Second, non-bank credit organizations, including finance companies and mortgage institutions have insignificant combined weight in the financial sector. Trinidad and Tobago is the only country where these types of institutions have thrived.
- Third, foreign bank ownership is significant in most countries, exceeding 50% of total sector assets in five of the eight countries. Trinidad is the only economy where foreign ownership is less than 40%.
- Fourth, state-controlled banks hold the majority of banking sector assets in the OECS. Three of the six countries have very large state-controlled banks.
- Finally, regional banks and financial groups play an important role in the region. The cross-holdings among financial groups represent a concentration of assets and influence.

#### ***Bank Governance/management***

Comments on the governance and management of the focus country banks can best be made based on their ownership structure: (1) large Canadian-owned international banks, (2) domestic state-controlled banks, (3) publicly-held domestic banks, and (4) privately-held domestic banks.

- **Large Canadian-owned banks:** Regarding the large Canadian-owned international banks, there are no obvious shortcomings in governance or management; governance policies and procedures are

established at their headquarters and management functions according to the corporate culture of large international banks. All of the Canadian banks are publicly quoted in Canada, where there is substantial scrutiny of governance policies and practices.

- **Domestic State-controlled banks:** Governance of the domestic state-controlled banks is a more complex issue, particularly in the OECS countries where the banks are considered to have weakened themselves due to their over exposure to government securities and government-sponsored projects (This is discussed later in the report). In undertaking these financings, however, the management of these banks is responding to governance mechanisms established by their owner – the state – and therefore fulfilling a standard governance requirement that management manage in accordance with the objectives of the owner. There is an absence of a distinct governance framework for public institutions that can mitigate political intervention and make each institution accountable to the public on commercial criteria.
- **Publicly held banks:** The major publicly-held banking entities in the region are RBTT Financial Holdings and Republic Bank Ltd. although 12.5 percent of FCIB's shares are publicly quoted, as are some of the shares of Scotia Bank TT. Bank of Nevis is also a quoted company, despite having total assets of under USD 100 million. Two governance-related issues stand out. First, obtaining ownership information about these entities is not always the straightforward matter. Governance information is not always included in annual reports, nor is it readily available from the securities exchanges. Second, there is a notable degree of overlap between the major banking groups. The multi-jurisdiction and multi-sector activities of these groups also make it difficult for the market and the supervisory agencies to monitor their activities effectively, which is another aspect of corporate governance. Finally, there is little relevant public information available about the privately held domestic banks that would make it possible to comment on their governance or management.
- A similar situation prevails for the credit unions, which are not required to make information available to the public. However, it is relevant to note that it is standard practice for small credit unions to be managed by their membership, thereby creating obvious corporate governance risks.

#### Examples of Cross-Holdings Among Banks

- FCIB hold an 8.8 percent share in Republic Bank
- Guardian Holding's holds a 14 percent share in RBTT Financial Holdings
- RBTT's has holdings in a Guardian Holding subsidiary
- CL Financial's holds a combined 33.6 percent share in Republic Bank
- Holdings of RBTT and Republic in Scotia Bank TT

### ***Recent restructuring initiatives***

None of the Focus Countries has undertaken a major financial sector or banking sector restructuring in recent years. There are ongoing efforts at improvement, often with the assistance of IMF diagnostics; one such effort that is discussed later in this report is strengthening bank and non-bank supervision in all of the Focus Countries.

Smaller scale restructuring efforts worthy of note are the sale of 63 percent of the state's stake in Barbados National Bank to Republic Bank in 2003; the sale of the state's majority share of the Bank of St. Lucia to the public in 1999; and the restructuring of the state-controlled National Commercial Bank of St. Vincent in 2002. On the private banking side, the 2002 merger of the Caribbean operations of Barclays Bank and Canadian International Bank of Commerce had a major impact on the financial sector markets, by creating a banking entity of over USD 9 billion in assets - twice the size of RBTT Holdings, the next large banking entity in the region.

## **CREDIT UNIONS**

The contribution of credit unions to financial intermediation has grown rapidly in the past few years, indicating a demand for financial products by the informal sectors of the economy typically served by credit unions. Penetration rates - defined as the percentage of the economically active population that belongs to a credit union - range from a low of 24 percent in Antigua and Barbuda to a high of 152 percent in Dominica (the latter indicating multiple credit union memberships).

Growth of credit union activity is to be welcomed on one hand, because credit unions often fill a financial services gap not addressed by the banks, particularly in making loans to borrowers whose needs may be too small for them to be of interest to commercial banks and/or who do not have the financial track record typically required by commercial banks<sup>11</sup>.

The negative side of credit union loan growth is that many of the credit unions, as well as their legal and regulatory infrastructure, are not sufficiently developed to accommodate such growth. In Barbados, for example, the IMF estimates that credit union loan delinquencies accounted for 20 percent of total loans as March 31, 2002.<sup>12</sup> In the case of Trinidad and Tobago, the government Green Paper estimates that some credit unions could also have delinquency rates as high as 20 percent.<sup>13</sup> They are vulnerable due to low levels of reserves and problem loans. There are many inactive or small credit unions that provide limited services at best, although others are more active and responsive to member needs. Significant investment and training will be needed to better implement PEARLS, and to make the credit unions more active and competitive. As elsewhere in the region, this may require some consolidation of credit unions, or at least their back office operations. Tougher discipline will also be needed at some credit unions to bring delinquencies down.

Credit union loan quality information for the OECS is not available. Efforts underway to address these issues are discussed later in this report, as are recommendations for a USAID intervention.

## **MICRO FINANCE INSTITUTIONS**

Micro finance lending plays a relatively small role in all of the Focus Countries, both because it is not a major financial sector focus and because micro finance loans are small by definition and therefore typically account for a relatively low proportion of a country's total lending. Nevertheless, there are two reasons why micro finance lending is an important topic for this report. First, the economic challenges facing all of the Focus Countries, and in particular the high unemployment and poverty rates, have provided fertile ground for the development of the micro enterprise sector in other emerging economies. Second, and presumably related to the first point, there is a widespread perception among policy-makers and donors that there is a shortage of micro finance lending. As will be discussed again under Recommendations, there is a notable lack of information about the supply and demand of micro finance in the region, particularly in light of the two preceding considerations. It is important to note that this lack of information applies to the small business sector as well.

Historically the National Development Foundations and other government and donor initiatives have done most micro finance lending; the National Development Foundations were established throughout the region in the early 1980s to contribute to economic development, including reducing poverty. National

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<sup>11</sup> It should be noted, however, that it is not possible to state conclusively what proportion of credit union lending actually is for micro/small business purposes, instead of for consumer purposes. The credit unions themselves do not always make this differentiation and in any case borrowers can use consumer loans for business purposes and vice versa.

<sup>12</sup> IMF, "Barbados," p. 23.

<sup>13</sup> Cabinet Appointed Committee to Review the Financial Sector of Trinidad and Tobago, "Final Report on the Financial Sector of Trinidad and Tobago," December 20, 2002. This report is often referred to as "The Green Paper."

Development Foundations still exist today in the majority of the Focus Countries, typically providing a combination of micro finance loans and business services. Other government- and/or donor-initiated sources of micro finance (debt and equity) in the Focus Countries all operate on a small scale but none of these is considered to have yet been notably successful in terms of achieving an appropriate combination of outreach, impact and financial sustainability. (Although it must also be noted that programs focusing on poverty reduction do not necessarily have a financial sustainability objective.) Various commercial and quasi-commercial efforts have been undertaken to serve micro entrepreneurs, but only one – Microfin<sup>14</sup> – is actively operating at present, with a division in Trinidad and Tobago and subsidiaries in St. Lucia and Grenada.<sup>15</sup> It is assumed that at least some credit unions include micro entrepreneurs in their membership base, but there is no specific information available.

Sustainability Rate Estimates of Microfinance Institutions By Country (Revenue/Expenses)	
St. Vincent and the Grenadines:	66%
Grenada:	75 %
St. Kitts and Nevis:	103 %
Dominica:	105 %

Donor- and state-supported micro finance organizations in the Focus Countries have realized the same shortcomings as they have all over the world; their reliance on donor funding calls their long-term sustainability into question, both because donor funding may not always be available and because such “soft money” does not force the NGOs to achieve self-sustaining levels of profitability. A UNDP review of four National Development Foundations in the OECS supports this point by calculating the “sustainability” rates (typically defined as the degree to which revenues cover expenses) shown in the side box.

Even the positive ratios achieved in St. Kitts and Nevis are not high enough to enable these organizations to grow based on retained earnings. Note also that, according to a confidential donor report, the NDF in Grenada had a delinquency rate of 18 percent and St. Lucia had a loan recovery rate of only 30 percent as of 2000-2001.

Another means of gauging the results of NGO-provided micro finance is to assess the gap between micro finance supply and demand in the Focus Countries. Although official data is not available, a 1999 study undertaken for Microfin’s founder, DFL, provides useful data, which, although now outdated, provides a sense of the numbers involved. Several key points are revealed by this data.<sup>16</sup> First, there clearly is unmet demand for micro finance. Second, the scale of demand is fully achievable; estimated demand in the OECS is approximately USD 22 million, which represents less than 1 percent of OECS banking sector assets. Third, because the scale of demand is achievable, care must be taken not to over lend to the micro enterprise sector; saturation of the market could weaken lending practices and make it impossible to serve this market on a commercially sustainable basis. This is another issue that is addressed under Recommendations.

<sup>14</sup> Caribbean Microfinance Ltd. (Microfin) is a microfinance lender based in Trinidad and Tobago. Its founder and strategic investor is Development Finance Limited (DFL), a private sector development organization. Microfin’s other major shareholders include RBTT Financial Holdings, the Government of Trinidad and Tobago, the IDB and the European Investment Bank.

<sup>15</sup> According to a report commissioned by DFL, in the 1990s all five of the commercial banks operating in Grenada had various microfinance programs, but none of them has been sustained.

<sup>16</sup> A key assumption in these calculations is that microfinance currently accounts for 1 percent of all corporate loans provided in each country.

## Financial Sector Infrastructure

### ***Policy/system/legal Framework***

#### **BANKING AND INSURANCE**

A summary of the legal and regulatory framework for the banks in the Focus Countries is provided below. Although all of the countries are in the process of strengthening their supervisory regimes, none of the officials interviewed for this report expressed any need for additional assistance in implementing these improvements.

#### **BARBADOS**

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The primary banking sector legislation in Barbados is the Financial Institutions Act of 1996 (effective July 1, 1997). This Act assigns the responsibility of supervising, regulating and licensing commercial banks, other deposit-taking companies and some non-bank financial institutions (NBFIs) to the Ministry of Finance. An IMF review of banking supervision in Barbados concluded that the process was compliant or largely compliant with all but two of the Basel Core Principles, and that one of these principles was not relevant in any case. Although the report did not cite the non-compliant principle specifically, the following points were noted:

- The possibility that the Central Bank's independence could be constrained by the requirement that certain authorities be delegated by the Ministry of Finance. (Note that this requirement could also create delays in time-sensitive circumstances.)
- The Ministry of Finance must approve investments in the banking sector of over 20 percent; the IMF notes that this threshold is relatively high.
- Capital adequacy calculations only cover credit risk, not market risk.
- The Central Bank has not issued guidelines or regulations regarding lending and investment policies, internal control systems, country risk, market risk, transfer risk, or corporate governance.

The IMF also observes that the insurance industry has “hitherto relied primarily on the good faith of industry participants which exposes the sector to significant risks.” Given the cross-holdings between the insurance sector and the banking sector that have been noted, improved supervision of the insurance sector has important implications for the financial sector as a whole. The Office of the Supervisor of Insurance has requested technical assistance in this regard from the Caribbean Regional Technical Assistance Center (CARTAC).<sup>17</sup>

#### **TRINIDAD AND TOBAGO**

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The basic banking law in Trinidad and Tobago is the Financial Institutions Act of 1993. This is currently being revised to provide for consolidated financial institution supervision as well as more effective cross-border supervision and information sharing. In addition, separate new legislation governing the mergers of financial institutions is being developed.<sup>18</sup>

In its 2003 Article IV consultation, the IMF noted that “the banking sector appears sound,” but that there is a need to strengthen regulation of the non-bank financial sector. Legislation is currently being developed to strengthen the supervision of the insurance sector; as in the case of Barbados, this will have

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<sup>17</sup> IMF, “Barbados,” pp. 16-17 and 31-35.

<sup>18</sup> Green Paper, pp. iv and 8.

important implications for the financial sector overall.<sup>19</sup> Institutional capacity is needed to implement consolidated supervision, cross-border cooperation, and more effective information sharing.

Gaps and vulnerabilities that have been identified are outlined in the following box.

#### Summary of Key Findings Regarding Supervision of Banks and Insurance

- The legislative framework is not adequate with regard to information disclosure, prudential norms, mergers and acquisitions, electronic finance, and corporate governance issues.
- Insurance companies are considered particularly weak in terms of regulatory reporting. Credit unions are also considered weak in this regard. In addition, there are inconsistencies in the application of accounting standards.
- There is a need for greater information to be made available for public and market purposes.
- Regulatory and supervisory systems need to become more “risk-based” (as opposed to “rules-based”), and made consistent with a more integrated approach to financial services, in anticipation of more complex institutions and instruments. This will require a stronger mandate for enforcement, and the introduction of on-site inspections in the insurance sector.
- Supervisory capacity is short on manpower and financial resources, which weakens banking supervision as well as supervision of the credit unions and NBFIs. Additional resources will be needed to increase on-site inspections, enhance off-site surveillance capacity, coordinate strategies and policy, and integrate supervisory policy to pre-empt dangerous risks from materializing and spreading to the system as a whole.
- Clearing and settlement need more effective oversight.
- Tax reform is needed to provide incentives for market development, but with a time line for termination of incentives when markets have developed.
- Telecommunications infrastructure is inadequate for modern financial services.
- Competition policy needs strengthening to address monopoly, consumer issues, and compliance with international agreements.
- Reserve requirements are currently discriminatory against banks, as they do not apply to non-bank deposit-takers in the system. Banks are required to keep 18 percent reserves, while some NBFIs are only required to have 9 percent (e.g., other lenders apart from credit unions). Given that insurance companies and other NBFIs accept deposits, the authorities will need to smooth out the difference in treatment to stimulate desired competition.
- The new Basel Capital Accord may create competitive challenges for indigenous banks, as larger global banks (e.g., Citigroup, Scotiabank to a lesser extent) may not be required to maintain capital adequacy at the same recommended ratios as smaller banks. At a minimum, with expansion and competitive challenges at hand, the indigenous banks will need to strengthen earnings, and retain those earnings for growth. Increasing earnings will not only be a revenue issue. TT banks will need to reduce their comparatively high operating costs, which will be difficult due to the small markets in which the indigenous banks operate.

#### OECS

The key banking law in the OECS is the Uniform Banking Act; this law establishes the role of the ECCB as the banking sector’s supervisory and regulatory body. The ECCB is responsible specifically for supervising commercial banks, development banks, mortgage finance companies and other finance companies. In addition, the ECCB is in the process of expanding its supervisory and regulatory responsibilities in the non-bank financial institutions sector by establishing a consolidated supervisory unit in each member country. These units will be responsible for supervising offshore financial institutions, insurance companies, mutual funds, money transfer agencies and micro finance institutions.<sup>20</sup>

<sup>19</sup> IMF, “Trinidad,” p. 19.

<sup>20</sup> IMF, “ECCU,” p. 69

With the regard to the banking sector, the IMF states that, although the legal and regulatory framework is “broadly in line” with the Basel Core Principles on Effective Banking Supervision, they note the following shortcomings:

- Bank licenses are issued by the Ministries of Finance in each member country and, although, consultation with the ECCB is required, there is no mechanism requiring that the ECCB’s recommendations be incorporated into the licensing decision.
- The ECCB does not have the authority to intervene in weak banks (unless they pose a serious risk to a member country’s financial system), including requiring corrective actions and imposing penalties on banks that do not implement the required corrections. The ECCB also does not have the authority to issue cease and desist orders.<sup>21</sup>
- Limited provisions for sharing information with supervisors from other countries or with international organizations such as the IMF.
- No formal allowance for issuing prudential regulations, including for risk-weighted capital adequacy; for requiring regular publication of financial statements; or for allowing consolidated supervision.
- Lack of a formal lender of last resort facility.<sup>22</sup>

## **CREDIT UNIONS**

### **BARBADOS**

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The Cooperative Society Act of 1993 governs credit unions in Barbados; the Registrar of Cooperatives has historically supervised the unions. This organization is understaffed, however, and has not been able to do the annual on-site reviews of each credit union that are considered necessary. As a result, the five largest credit unions, which account for 81 percent of credit union assets, are now being supervised jointly with the Central Bank. Amendments to the credit union law are under discussion although, according to the IMF, the proposed amendments are inadequate because they do not include sufficient prudential regulations or sanctioning ability for the supervisory authority.<sup>23</sup>

### **TRINIDAD AND TOBAGO**

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The Department has supervised credit unions in Trinidad and Tobago in the past for Cooperative Development, which is part of the Ministry of Labor and Cooperatives; this positioning of the supervisory authority reflects the social development role attributed to the credit unions. As in the case of Barbados, however, this department has insufficient personnel and financial resources to fulfill its responsibilities. As a result, a newly created Credit Union Supervisory Unit (CUSU) in the Ministry of Finance will also play a supervisory role (which is still being defined).

The Cooperative Society Act of 1971 governs the credit unions; as in the case of Barbados, this law is also under discussion for amendments, including the appropriate allocation of authority between the Department for Cooperative Development in the Ministry of Labor and Cooperatives and the newly established CUSU in the Ministry of Finance. According to the Trinidad and Tobago Green Paper on the financial sector, “most credit union practitioners believe that it [the law] needs a complete overhaul.”<sup>24</sup>

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<sup>21</sup> The Minister of Finance in the appropriate jurisdiction can revoke a bank’s license upon the ECCB’s recommendations, but only with a minimum of thirty days notice to the bank. IMF, “ECCU,” p. 88.

<sup>22</sup> IMF, “ECCU,” pp. 81-84. The lender of last resort facility is discussed on pages 86-87.

<sup>23</sup> IMF, “Barbados,” p. 23.

<sup>24</sup> Green Paper, p. 30.

## OECS

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Credit union supervision in the OECS countries has historically been the responsibility of local registrars or commissioners in each country. The organizational location of these entities varies from the Ministry of Labor, Home Affairs and Cooperatives in Antigua and Barbuda; to the Ministry of Community Development, Social Affairs, Sports and Cooperatives in St. Lucia; to the Ministry of Finance in Anguilla. The OECS governments and the ECCB recognize the need to enhance this supervisory structure and two complementary strengthening measures are underway. One is to emphasize greater self-regulation, to be implemented by the Caribbean Confederation of Credit Unions (CCCU). The other is to increase oversight by the ECCB. The possibility of putting credit unions under the direct supervision of the ECCB is also being discussed, but this is a considerably longer term undertaking that would require legislative approval by each member country. The vehicle that would be utilized is the consolidated supervisory units that the ECCB is establishing in each member country to regulate non-bank financial institutions. This report includes a recommendation that USAID build on an existing donor initiative to strengthen the CCCU's self-regulatory capacity.

### **Payment systems**

Barbados is at the forefront of the Focus Countries with regard to strengthening its payment systems, having recently implemented an automated clearing house (ACH) for small transactions and a real time gross settlement system (RTGS) for larger and time-critical transactions.

The RTGS is considered a systemically important payment system and was designed to satisfy the Core Principles for Payment Systems (CPPS) established by the Bank for International Settlements. A recent assessment of the system conducted by the World Bank (as part of a joint assessment with the IMF) concluded "the RTGS functionality [in Barbados] is similar to that observed in advanced economic markets." (p. 40)

Trinidad and Tobago is also in the process of modernizing its payment systems; a project is currently in process to implement a RTGS system and a Request for Proposal has been issued by the commercial banks for implementing an ACH system.

With regard to the OECS, a study has been done on implementing ACH for small value payments and the ECCB is preparing a proposal for automated settlement process for larger/time sensitive payments. A study has already been done regarding creating an ACH system between OECS banks.

### **Accounting framework**

All but three of the Focus Countries are members of the Institute of Chartered Accountants of the Caribbean (ICAC). The ICAC was established in Jamaica in 1985 and its objectives include promoting international best practice; fostering self-regulation, including monitoring; and standardizing entry regulation and rules of professional conduct for its member institutes. Local institutes in the Focus Countries are in Barbados, Trinidad and Tobago, St. Kitts and Nevis and St. Lucia. All of the member institutes in the Focus Countries have formally adopted International Financial Review Standards (IFRS) and International Standards on Auditing (ISA). However, as the Institute itself notes in its annual report of 2002, "the extent of implementation [of IFRS and ISA] varies."<sup>25</sup>

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<sup>25</sup> Note, however, that a World-Bank approved consultant conducted a Report of Observance of Standards and Codes (ROSC) for Trinidad and Tobago as a pre-condition for IDB funding; this consultant concluded that "compliance with IAS by listed companies in Trinidad and Tobago was generally good." Institute of Chartered Accountants of the Caribbean, "2002 Annual Report," p. 16.

Several broad scale efforts to strengthen the actual implementation of accounting and auditing standards are underway. The IDB is already working with the ICAC in Trinidad and Tobago, in addition to formulating a regional strategy with the ICAC on auditing and accounting standards that would cover Barbados, the Bahamas, Guyana and Suriname.<sup>26</sup> In addition, there is a Heads of Government agreement in the OECS regarding establishing an Institute of Chartered Accountants of the Eastern Caribbean, to be housed at the ECCB. (A law establishing the institute must be adopted by each OECS member state.) This report includes a recommendation that USAID implement a program in the OECS similar to that of the IDB.

### **Rating agencies**

The Focus Countries do not have any indigenous rating agencies; therefore any government debt issues and international firms such as Standard & Poor's and Moody's rate large corporate issues aimed at international investors. Approximately forty entities in the Caribbean (not just in the Focus Countries) have obtained such ratings. It is relevant to note that none of the OECS governments has a rating for its debt.

This situation is changing. A regional rating agency is being developed by several financial organizations based in Trinidad and Tobago. The lead role in this initiative is being taken by Caribbean Money Market Brokers (CMMB),<sup>27</sup> with support from the Central Bank of Trinidad and Tobago.<sup>28</sup> The operating assumption for the creation of this new agency is that a regional scale rating system (benchmarked to international ratings) would provide a more relevant context for rating local borrowers, because it would not be as constrained by the international rating applied to the country's sovereign borrower.<sup>29</sup>

A regionally-based rating agency would also have a different cost structure than the international rating agencies and therefore its rating fees would be more accessible for more companies. The result is that more borrowers would have a capital markets alternative to bank borrowing, with the ensuing competition likely to reduce borrowing costs. In Trinidad and Tobago, as an example, the 90-day government T-bill rate, which serves as the risk-free rate, is 5 percent, compared to the prime rate of 11.5 percent. Although top-tier clients borrow below the prime rate, the 650 basis point range arguably does provide some borrowers room to improve on their bank borrowing costs.

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<sup>26</sup> Note that the OECS is not a member of the IDB; the mechanism typically used by the IDB to work with OECS countries is to work with the Caribbean Development Bank as an intermediary.

<sup>27</sup> CMMB is a joint venture between CL Financial Ltd. (a financial conglomerate); Cllico Investment Bank Ltd., which is part of the CL Financial Group; and Jamaica Money Market Brokers Ltd.

<sup>28</sup> Other organizations that funded the feasibility study were Unit Trust Corporation, First Citizens Bank Limited, RBTT Bank Limited, Citibank, Jamaica Money Market Brokers Limited, Republic Bank Limited, Caribbean Money Market Brokers, Scotia Bank, Intercommercial Bank, CL Financial and Guardian Holdings.

<sup>29</sup> The standard methodology applied by the international rating agencies is to gear all of a country's ratings off of the sovereign rating, on the assumption that the country's sovereign borrower represents the country's best risk level. This assumption creates a problem for companies in countries in which the sovereign rating is low on an international scale, particularly if it is below investment grade, because it implies that even the best companies in the country (which might even arguably be better credit risks than the sovereign) will not be able to get investment grade ratings. As a result, there is often little incentive for even the best companies in such countries to acquire international ratings. With domestic scale ratings, the sovereign borrower is typically given the highest rating available, such as triple A, thereby opening the complete scale of ratings to other borrowers and providing a local context for evaluating risk. For example, by acquiring a rating, a second tier Barbados company would enable investors to compare its risk with that of the Barbados government as well as other companies in Barbados and the region. Although the company's risk might be rated below investment grade on an international scale, a second tier risk on a regional scale could well be acceptable to those familiar with the market, provided that it was priced appropriately. To date, however, the Focus Countries have not had a rating system to provide this risk evaluation from a regional perspective.

As of the writing of this report, the planning process for rating agency development was still in process. Shareholders from across the region are being invited to join; the plan calls for wide representation in terms of geography and types of shareholder in order to ensure that the agency has the necessary level of independence and credibility. The target shareholder structure is for 20 percent ownership by central banks in the region; 20 percent ownership by multilateral agencies; 20 percent ownership by Crisil, an S&P affiliate in India that undertook the feasibility study and will serve as the technical adviser; and 40 percent ownership by 15-20 market participants. The CDB and the IDB have both been approached as potential investors. We recommend in Part V of this report that USAID assist this agency in developing successful demonstration projects.

### ***Credit bureaus***

The only significant credit bureau in the Focus Countries is The Credit Bureau of Trinidad and Tobago, which was founded eighteen years ago by a law firm and collection agency. The bureau currently holds over 350,000 records and reviews an average of approximately 10,000 credit applications a month (individual and corporate applications). The banks in Trinidad and Tobago have recently decided to create their own platform for exchanging credit information, in which The Credit Bureau of Trinidad and Tobago will also be included.

A Barbados-based company (Prism) has recently completed a feasibility study on a regional credit bureau (Barbados, Trinidad and Tobago, Jamaica and the OECS) and concluded that there is sufficient demand for such a service. However, although the majority of interviewees in the Focus Countries agreed that a credit bureau would be useful, there is currently no initiative underway to create one. In Part V of this report we recommend that USAID attempt to jumpstart this process.

### ***Collateral registries***

The systems for collateral identification and documentation of property in most of the Focus Countries are underdeveloped for the needs of a modern financial system. They derive from their British colonial history, which was oriented towards maintaining ownership of large parcels of fixed property, mostly land, rather than facilitating efficient property transfer. Trinidad appears to be the only country that has made marked improvement in cadastre reform for land. But when compared to similar systems in other countries or systems still using deeds, there are significant variances among countries.

Registries for collateral (movable property or real estate) are not sufficiently developed in any country, and in most cases they suffer from one or more impediments. Some of the noted weaknesses include the following: complex and outdated registration processes, lack of adequate maintenance of registry operations, public-private duality of property ownership regimes; unclear titling or persistence of multiple property rights, legal and administrative inefficiencies in perfecting, enforcing and/or creating security interests. The upshot of these conditions is that the cost of issuing credit is increased; a disproportionate amount of lending is made on an unsecured – or unconventional – basis; loans are not made; and/or loans are made that should not have been made.

Weaknesses in the collateral-registration environment and an abundance of “under” or non-secured credit in the system also have an impact a broader environmental impact. First, they make it very difficult to restructure banks. Second, they make it very difficult for merchants who are willing to sell on credit to poor customers with good reputation, to get credit back by their receivables or inventories. Third, it can hamper the growth of manufacturing or capital-intensive businesses that rely on secured term loans to finance equipment and facilities.

## Financial Sector Development Based Prudential Norms

### **Banking Sector Soundness<sup>30</sup>**

The following summary of banking sector financial soundness addresses four issues: capital adequacy, asset quality, liquidity and earnings. As an overall summary, there are no major concerns regarding banking sector soundness in either Barbados or Trinidad and Tobago. They appear to have surplus liquidity, based on relatively low rates of lending as a proportion of banking sector assets. However, the following observations were made:

#### **BARBADOS**

Credit risk represents the main threat to commercial banks in the current environment. The economy of Barbados is particularly sensitive to business cycles in the United States, the United Kingdom, and Canada through their effects on tourism. Another consideration is that the construction sector expanded significantly during a boom that ended in 1999. As a result, land and real estate prices that had accelerated during the boom suffered a decline. This decline suggests a fall in the value of banks' collateral. Finally, the manufacturing sector has suffered owing to rising costs and increased competition from producers abroad.<sup>31</sup>

#### **TRINIDAD**

Banks will face competitive challenges to earnings as well as regulatory challenges in the form of the new Basel Capital Accord. There is also the ongoing issue of economies of scale and critical mass, all challenges for the indigenous banks even as they spread out into other markets. Consequently, operating costs have historically been fairly high as a share of income when compared with other major OECD countries, although these costs are comparable to those of Japan.

#### **OECS**

In the case of the OECS, an overview of the banking sector is essentially an overview of the state-controlled banks, because of the dominant position that they hold in terms of total banking sector assets. The major concern for these banks is the high level of exposure to government risk and under-performing loan portfolios. However, it should be stressed that the discussion of banking sector soundness in the OECS concerns only domestically incorporated banks; non-incorporated branches of foreign banks operating in OECS countries, which in some cases account for approximately half of banking sector assets, are not included because they do not report independently to the ECCB. The following comment by the IMF is also relevant to the following discussion: "The unavailability of detailed individual bank data thwarts a robust assessment of the banking sector. Nevertheless, the aggregated banking soundness indicators that are compiled by the ECCB, point at some issues of concern but without suggesting an overall assessment that the banking sector is unsound."<sup>32</sup>

For an in-depth overview of banking sector financial soundness addressing capital adequacy, asset quality, liquidity and earnings, please refer to Annex A.

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<sup>30</sup> Section three in the Statement of Work is entitled "Financial Sector Development Based Prudential Norms," with subsections related to different aspects of risk. Because the first subsection, "operating environment," is covered under "Financial Sector Infrastructure" (2) and "Economic Factors/Indicators" (5), this first subsection will instead address financial soundness of the banking sector.

<sup>31</sup> *Ibid*, p 18.

<sup>32</sup> IMF, "ECCU," p. 81.

### ***Transparency and Disclosure***

Transparency and disclosure in the banking sectors in the Focus Countries is barely adequate. Three shortcomings stand out in particular. First, as was noted, information about bank ownership is often not readily available to the public. Second, while most banks post at least some financial information on their web sites, many do not include the notes to the annual audited statements, thereby making it unnecessarily difficult for potential clients and investors to obtain this information. Third, the different year-end reporting dates used by different banks makes it extremely difficult to compare their performance in a meaningful way. The hurdles posed to obtaining these basic building blocks of information – ownership, complete financial statements, and comparative information – create the impression of a banking culture in which transparency is not highly valued.

In the case of credit unions, there are no mandatory disclosure requirements in any of the Focus Countries.

### ***Sensitivity to Market Risk and Foreign Exchange Risk***

Market risk is not a major concern in Trinidad and Tobago or Barbados. Securities held by the banks are primarily domestic government securities and the generally acceptable financial condition of the Barbados and Trinidad and Tobago governments (discussed later in this report) raise little concern regarding a significant change in the value of their debt obligations. (Trinidad and Tobago's long-term foreign currency debt has an S&P rating of BBB and Barbados's rating is A+.) Nevertheless, as was noted above, the Central Bank of Barbados does not actively monitor market risk assumed by the banks.

Market risk is a more significant issue in the OECS, where only one of the six focus country governments (St. Lucia) has a debt/GDP ratio of under 60 percent, which is the ECCB's proposed maximum ratio for this parameter.<sup>33</sup> Furthermore, in at least two of these countries the banking sector has relatively large holdings of domestic government securities (over 8 percent of total assets); it is generally assumed that the banks holding most of this debt are state-controlled. In any case, these holdings raise the overall vulnerability of these economies if a government default should occur. For details, see Annex A, Table 12.

A comparable situation exists in the area of foreign exchange risk: it is relatively limited in Barbados and Trinidad and Tobago and of greater concern in the OECS. Trinidad and Tobago has a managed float regime in which exchange rates have been stable since 1993, while Barbados's exchange rate has been pegged to the US dollar since 1975. As noted above, relatively sound financial management by these two governments does not raise concern about unanticipated exchange rate changes. Furthermore, the banks in both countries tend to operate largely in their domestic currency, so there are not significant currency mismatches between their assets and liabilities. (Foreign currency assets accounted for less than 1 percent of total banking sector assets in Trinidad and Tobago at year-end 2002 and were exceeded by foreign currency liabilities by USD 133 million. In Barbados foreign currency liabilities accounted for 6.8 percent of total banking assets and exceeded foreign currency assets by USD 179 million.)

The OECS has a modified currency board system in which demand liabilities are 97 percent backed by net foreign assets and the ECCB's lending to member governments is limited to a maximum of 40 percent of each government's liquid assets.<sup>34</sup> Such a system is quite stable under normal circumstances but as with any other fixed rate system, it runs the risk of substantial instability if the system ever has to be changed. There are currently two sources of potential instability in the OECS currency board. First, as

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<sup>33</sup> This issue is discussed in IMF, "ECCU," pp. 48-53.

<sup>34</sup> IMF, "ECCU," footnote 35 (p. 51) and p. 71.

was noted, some of the member countries are borrowing at unsustainably high levels.<sup>35</sup> Second, financial irresponsibility on the part of one currency board member ultimately harms all members, who have to pay for the increased risk with higher interest rates. Both of these issues are being addressed by the ECCB, which has established fiscal benchmarks for member countries to achieve (although the benchmarks are not binding).<sup>36</sup> The IMF notes that net foreign currency exposure by the commercial banks is very low.<sup>37</sup>

### **Soundness of Non-bank and Informal Sector Organizations**

As was noted, the negative side of credit union loan growth rate is that most of the credit unions themselves, in addition to the legal and regulatory infrastructure, are not sufficiently developed to accommodate this growth.

#### **BARBADOS**

There have been some shortcomings noted in the credit union supervisory framework. As a result, it is not surprising that the IMF estimate a 20 percent loan default rate as of March 31, 2002 for the credit unions in Barbados. According to the Barbados Cooperative & Credit Union League, there is considerable variation across the 41 credit unions in terms of size, management and financial performance.

#### **TRINIDAD AND TOBAGO**

The Green Paper on the Trinidad and Tobago financial sector estimated that some credit unions could also have default rates in that range. Regardless, credit unions are vulnerable due to low levels of reserves and problem loans. There are many inactive or small credit unions that provide limited services at best, although others are more active and responsive to member needs. Significant investment and training will be needed to better implement PEARLS, and to make the credit unions more active and competitive. As elsewhere in the region, this may require some consolidation of credit unions, or at least their back office operations. Tougher discipline will also be needed at some credit unions to bring delinquencies down.

Delinquency estimates are not available for the OECS. However, findings indicating the condition of the credit unions are outlined below.

#### **Snapshot of Soundness of Credit Unions in the OECS**

- **Antigua & Barbuda:** Many credit unions are likely insolvent. Reserves are low relative to problem loans. Credit unions in Antigua need significant investment in systems for modernization. To date, their penetration rate in Antigua has been low by OECS standards.
- **Dominica:** Credit unions are vulnerable due to low levels of reserves relative to problem loans.
- **Grenada:** In order to benefit the potential small borrower, particularly the micro-enterprise borrower, the needs of the credit unions in Grenada should be carefully studied. Given the lack of rigorous supervision and no prudential regulations, there is a paucity of relevant data on the credit unions in Grenada. Reportedly, there is considerable variation across the 22 credit unions in terms of size, management and financial performance. It is more than likely that some of the smaller, weak credit unions would benefit from being merged into some of the large, strong ones.
- **St. Kitts and Nevis:** In order to benefit the potential small borrower, particularly the micro-enterprise borrower, the needs of the credit unions in St. Kitts & Nevis should be carefully studied. Given the lack of rigorous supervision and no prudential regulations, there is a paucity of relevant data on the credit unions. There is considerable variation across the 4 credit unions in terms of size, management and financial performance.
- **St. Lucia:** Many credit unions are also likely to be vulnerable due to low levels of reserves relative to problem loans.
- **St. Vincent and Grenadines:** It was unclear whether the information received from the three largest and most profitable credit unions was accurate. These institutions clearly need more rigorous supervision in order to determine their actual condition.

<sup>35</sup> This issue is discussed in IMF, "ECCU," pp. 54-58.

<sup>36</sup> IMF, "ECCU," pp. 46-52.

<sup>37</sup> IMF, "ECCU," pp. 66-67.

## Financial Sector Intermediation Indicators

### **Depth: Commercial Bank Credit Relative to GDP; Private Sector Credit Relative to GDP**

Before beginning a discussion of banking sector intermediation, it is important to take note of the reserve requirements, which have a direct impact on the funds available to the banks for lending. These requirements are outlined below.

Starting with the overall intermediation indicator of banking sector assets relative to GDP (BSA/GDP), the figures for Trinidad and Tobago (65 percent) and Barbados (53 percent) are relatively low both on an international comparative basis and compared to the OECS, where all of the member countries have ratios well exceeding 100 percent - figures that are actually quite high for emerging economies. By comparison, the ratio of BSA/GDP in the UK is 294 percent, in the Euro area it is 245 percent, and even in the US, where there has been substantial banking sector disintermediation, the figure is 77 percent.<sup>38</sup>

#### Reserve Requirements in the Focus Countries

Barbados:	21 percent
Trinidad:	18 percent
OECS:	6 percent

The most probable explanation for this outcome is that Trinidad and Tobago and Barbados have a relatively larger proportion of larger companies that have the option of doing their banking business offshore, compared to the private sector in the OECS. The oil and gas business in Trinidad and Tobago is a particularly good example; it is an important contributor to GDP but its borrowing needs tend to be too large for the domestically based banks.

This assumption would seem to be supported by the ratio of total loans/total assets (TL/TA). Although the figures are higher in the OECS (ranging from 55 percent to 71 percent) than in Trinidad and Tobago (42 percent) and Barbados (50 percent), the scale of the difference is not as marked as with the BSA/GDP ratio. Therefore the explanation could be that the resources that go into the banking sector in Trinidad and Tobago and Barbados are being converted to lending; the anomaly is that the financing that contributes to GDP growth is not all being generated locally, resulting in a GDP figure that is high relative to banking sector assets. This possible explanation is supported by the deposit data discussed later in this report under Money, savings and credit: despite economic growth, the ratio of deposits/GDP in Trinidad and Tobago actually declines between 1999-2001.

Other important points (see Table 13 in Annex A) are the relatively high levels of public sector lending to total lending in the OECS, and in particular St. Kitts and Nevis (note also that these figures do not include holdings of government securities); and the high proportion of consumer lending and housing lending to total private sector lending. It is also noteworthy that in Barbados and Trinidad and Tobago, the only countries for which data is available, housing lending by non-banks either exceeds housing lending by banks (Trinidad and Tobago) or comes close to it (Barbados).

The final key point to note regarding lending in the Focus Countries is the relatively low proportion of non-consumer private sector lending to total lending (see Table 14 in Annex A). This ratio is only in the 50 percent range in Barbados and Trinidad and Tobago, and falls to an even lower 25 percent when compared to total assets in Barbados and 22 percent in Trinidad and Tobago. In the OECS the ratio of non-consumer private lending reaches a high of 68 percent in St. Lucia, but is in the 30-40 percent range in the other countries, and, excepting St. Lucia, in the 20 percent range relative to total assets.

<sup>38</sup> IMF International Financial Statistics

Looking at lending to specific sectors, agricultural lending is under 2 percent in every country except for St. Kitts and Nevis, where it is almost 20 percent<sup>39</sup>; manufacturing is well under 10 percent in every country except Trinidad and Tobago, where it reaches 9.55 percent; the proportion of distributive trades is relatively high, at an average of approximately 10 percent; tourism exceeds 10 percent in Barbados and St. Lucia; and entertainment reaches 12.3 percent in Barbados. (Note also that lending to the petroleum sector, which is not in the table, is 14.6 percent in Trinidad and Tobago.)

As will be discussed later in this report under Private sector development, this lending structure largely reflects the nature of the underlying economies. There is relatively little manufacturing; therefore distribution of imported finished goods plays a relatively significant role; and tourism is also relatively important. However, although the sector allocations are much as would be expected, the relatively low proportion of non-consumer private sector lending overall is striking.

### ***Consumer Demand for Financial Products and Access to Them***

Consumer lending is clearly the dominant business, accounting for a high of 67 percent of private sector lending in St. Vincent and the Grenadines and a low of 44 percent in Trinidad and Tobago. This relatively high proportion of consumer lending is somewhat misleading, because these ratios are more common in fully mature economies in which large corporations have largely disintermediated from the banking sector, leaving the banks to focus on smaller borrowers such as consumers. While this may be the case to some extent in Trinidad and Tobago and Barbados, for reasons noted above, the high degree of consumer lending in the OECS is arguably more the result of a relatively small corporate sector. These levels of consumer lending do indicate the degree of competitiveness in the consumer finance market, as is also evidenced by the wide range of products available.

The table here indicates that the level of consumer lending in some countries, such as Antigua and Barbuda and St. Kitts and Nevis, may actually be cause for concern (although note that the data includes mortgage loans). For comparison with these debt figures, average per capita income in the OECS is USD 5200.

Housing finance is the main consumer finance sub-category in all of the Focus Countries (with a high of 43 percent of private lending in St. Vincent and the Grenadines) except Trinidad and Tobago, where it is a relatively low 11 percent. (As was noted, however, housing lending by non-banks accounts for another 76 percent of housing lending by banks in Barbados and another 128 percent in Trinidad and Tobago.) Given the rule of thumb that bank lending to a single sector should not exceed 25 percent of total lending, the figures in some of the OECS countries are worrisome.

**Consumer Lending Per Capital to  
Non-Poor Adults (2002)**  
(Consumer Credit/ Non-poor adults)

Barbados	\$ 6,601.00
Trinidad and Tobago	\$ 2,547.00
Antigua and Barbuda	\$10,378.00
Dominica	\$ 4,034.00
Grenada	\$ 6,712.00
St. Kitts and Nevis	\$10,846.00
St. Lucia	na
St. Vincent and the Grenadines	\$4,321.00

### ***Level of Competition, Diversity of Products, New Product Development***

Whether or not the banks in the Focus Countries are sufficiently competitive is an issue of concern to policy-makers in all of the countries. In Barbados a senior official has publicly accused the banks of collusion; Barbados also instituted maximum average lending rates from 2001-2003 in an attempt to force interest rates down and encourage more bank lending (the latter without success). In addition, all of the

<sup>39</sup> In the case of St. Kitts and Nevis, the total lending for the selected industries is 43.08 percent, compared to a calculation of non-consumer private lending of 28.41 percent. This is due to the fact that most of the agricultural lending in St. Kitts and Nevis is public sector lending.

Focus Countries have a mandated minimum savings rate to be paid by banks to depositors; the implication being that the banks are making inappropriately high profits to the detriment of depositors.

Collusion is a serious accusation that is beyond the scope of this report. Our approach to evaluating banking sector competitiveness in these markets was to evaluate the following three factors:

- The structure of the markets: is there a monopoly provider of financial services or, at the other extreme, are there too many small financial service providers to create effective competition; do the banks compete only among themselves or also with NBFIs?
- The behavior of the financial service providers: do they show a preference for the status quo or is innovation evident?
- Profitability: do profits seem unusually high compared to other markets, thereby indicating a possible failure of market forces to push profits down to the lowest competitive level?

Regarding market structure, the banking sectors in Barbados and in Trinidad and Tobago would both seem to be ideally suited to foster competition. Both markets have one large bank and a cluster of three similarly sized medium banks. The large banks in both countries are not so overwhelmingly large that one of the medium-sized banks could not eventually overtake it; furthermore, each of the three medium-sized banks would seem to have a natural incentive to differentiate itself by breaking away from its similarly-sized brethren. These two markets also have additional competition from NBFIs in the consumer finance sector, although notably not in the corporate finance sector.

Based largely on anecdotal evidence, it appears reasonable to assume that the market for corporate clients in Barbados and Trinidad and Tobago resembles a status quo market. The local “blue chips” and attractive medium-sized companies are a relatively fixed number of companies and, because banking in these countries is typically characterized as being based on relationships, these companies presumably rarely change their main banking relationships. Therefore the competition in this market is more likely to be based on product innovation and service rather than on pricing; all of the banks face similar cost structures and would achieve little benefit from getting new business at a lower return. One of the financial sector gaps discussed later in this report concerns the lack of competition to bank lending from the capital markets; such competition could dislodge this status quo by providing a wider range of borrowing options to the corporate sector.

In the case of the OECS, the presence of foreign bank branches in all of the Focus Countries has resulted in considerable competitiveness in the consumer finance market, as indicated by the high levels of consumer lending. It seems less likely that the market structure lends itself to competitiveness in the corporate market; the natural corporate lender would be a larger indigenous bank, but each of these countries only has one large indigenous bank, either state or privately owned. Although foreign bank branches could arguably serve as an intermediary for large corporate lending by their parent company banks, such branches are typically established to focus on the smaller end of the market and are therefore not organized in a way to enable them to pursue larger corporate business even on an opportunistic basis.

Turning to the behavior of the banks, this seems to indicate a high degree of competitiveness. The merger and acquisition activity that has been noted, which is characterized both by cross-border activity and by expanding into multiple fields of finance, is an important indication of the banks’ perceived need to continue to grow and diversify. The potential counter-argument is the cross-holdings between the banks; if one wished to further examine the charges of collusion, it would be in those relationships.

Also with regard to the behavior of the banks, there appears to be an appropriate level of product sophistication, innovation and diversity; this is particularly apparent in consumer finance, which is more easily judged because of the widespread marketing campaigns.

Finally, the profitability performance noted earlier in this report did not seem to indicate unduly high profit levels. In particular, net interest margins in the 5-6 percent range are not unusual in emerging economies; furthermore, the high level of consumer lending (which is unusual for emerging economies) would tend to keep interest rate margins high. As this report argues, the best test for whether corporate interest rates are too high would be to encourage the development of the capital markets as an alternative source of debt.

## **Economic Factors/indicators**

### ***General Trends***

An overview of the economies of the Focus Countries is in Table 15 (see Annex A). With the exception of Trinidad and Tobago, with its natural resource wealth, the economies of all of the Focus Countries experienced growth problems in 2001 and/or 2002 as a result of the global economic slowdown; a decline in tourism following September 11, 2001; and, for some of the OECS countries, a long drought. St. Lucia, St. Vincent and the Grenadines also suffered from the impact of tropical storm Lili of September 2002. Finally, Dominica, St. Vincent and the Grenadines and St. Lucia, which are all major banana producers, face the ongoing challenge of reducing their reliance on banana production in preparation for the expiration of EU preferences for Caribbean banana imports in 2005. As will be discussed below, reduced economic growth has fed into the banking sector and in most cases has resulted in a slow down in loan growth while deposit growth has continued.<sup>40</sup>

One additional point that applies to all of the Focus Countries is high unemployment rates and poverty rates; it is noteworthy that these apply even to Trinidad and Tobago (unemployment of 10.8 percent and poverty of 21.2 percent), despite its economic advantages.

For an in-depth analysis of each specific focus country, please refer to Annex A.

### ***Private Sector Development***

The most striking data regarding the private sector in the Focus Countries is the relatively low proportion of industry and manufacturing in all of the Focus Countries except for Trinidad and Tobago, where industry accounts for 44.9 percent of GDP, largely as a result of natural resource and related activity (see Annex A, Table 16). Another important point is the declines in agriculture that have occurred over the last ten years (see Annex A, Table 17) and the evidence that in many cases it is the services sector – not industry – that has taken up the slack. Finally, given the large size of the services sector in all of these countries, it should be noted, first, that services, as a sector can be less labor-intensive than agriculture, in addition to requiring a different set of skills. Therefore the shift from agriculture to services has presumably contributed to the unemployment rates that have been noted. Second, services arguably have lower financing needs than manufacturing, because they rely more on people than on bricks and mortar. Although many exceptions can be made to this latter point, such as the need for hotels in the tourism sector and for branches in financial services; nevertheless the high proportion of the service sector relative to GDP does provide a partial explanation to the relatively low level of lending to the real economy that has been seen in all of the Focus Countries.

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<sup>40</sup> Information sources for the following discussion are Economist Intelligence Reports and, for all of the countries except Antigua and Barbuda and St. Kitts and Nevis, reports on IMF Article IV consultations.

It should be noted in this context that, as is the case with micro enterprises, the Focus Countries also do not have databases regarding the small business sector. Therefore, even if policy-makers wished to encourage more enterprise growth and lending to the real sector, there is an absence of data with which to design programs and measure results.

### ***Money, Savings, Credit***

Table 18 shows the ratio of private sector loans/GDP and deposits/GDP for the years 1999-2001. The most striking information in this table is that the ratio of deposits/GDP has been on an increasing trend in every country except Trinidad and Tobago; by contrast, loans/GDP have decreased in Trinidad and Tobago and St. Kitts and Nevis; loans/GDP have increased by only 1 percent in Barbados; and in the countries in which loans/GDP increased by more than 1 percent, in no case did the increase exceed the increase in deposits/GDP.

Also in the context of banking sector savings it should be noted that Trinidad and Tobago has deposit insurance, Barbados is in the process of introducing deposit insurance, and deposit insurance does not exist in the OECS.

**Table 18: Loans and Deposits as a Percentage of GDP<sup>41</sup>**

% of GDP		1999	2000	2001
Barbados	loans/GDP	56.9	56.6	57.9
	deposits/GDP	82.2	83	102.1
Trinidad and Tobago	loans/GDP	33.9	31.8	29.9
	deposits/GDP	44.2	42	41
Antigua and Barbuda	loans/GDP	68.8	73.7	75.3
	deposits/GDP	86	90.3	94.8
Dominica	loans/GDP	n/a		
	deposits/GDP	n/a		
Grenada	loans/GDP	75.2	79.2	82.3
	deposits/GDP	82.7	88.1	101.5
St. Kitts and Nevis	loans/GDP	74.2	76.4	72.8
	deposits/GDP	72.1	85.9	83.9
St. Lucia	loans/GDP	80.7	87.7	85.6
	deposits/GDP	64.9	72.1	71.7
St. Vincent and the Grenadines	loans/GDP	61.2	65.4	64.4
	deposits/GDP	66.8	70.4	73.5

The question posed by these results is: why are banks not lending at a rate that keeps pace with their deposit funding? The simple short-term answer is that all of these countries except Trinidad and Tobago were heading into economic difficulties by 2001, so that banks were appropriately cutting back on lending. The longer term and more difficult question is whether lending will increase as the economies recover. The preceding analysis in this report makes it clear that increasing lending is not a simple undertaking.

<sup>41</sup> IMF International Financial Statistics

Although there appears to be room for increases in consumer lending in some countries, most notably Trinidad and Tobago (consumer debt/non-poor adult of USD 2597), in other countries such as St. Kitts and Nevis (USD 10,846) and Antigua and Barbuda (USD 10,378) these debt levels already appear high, even though they include mortgage finance.

In terms of corporate lending, it is not clear how much additional demand exists even in an economic growth scenario, particularly with manufacturing accounting for a relatively low proportion of GDP. As has been discussed, the banks tend to have long-standing relationships with their corporate clients; therefore it seems unlikely that this sector is “under banked.” Therefore it seems as if the only sector in which there might be unmet demand for new lending is in micro and small – or “emerging” – businesses. One firm quantified the existence of demand for micro loans in 1999 but more recent data is not available; there is no readily accessible data regarding small businesses. The recommendations in Part V of this report address this issue.

### ***Fiscal Policy***<sup>42</sup>

A summary of the status of the fiscal policies of the Focus Countries is as follows: Barbados undertook counter cyclical measures to stimulate the economy following the problems of 2001 and now must make efforts to reduce the proportion of government debt/GDP from its level of 4.25 percent as of fiscal year 2001/02; the main challenge facing Trinidad and Tobago is to ensure that it not exhaust its oil revenues precipitously and that it use the cushion provided by oil revenues to make important policy reforms; and the OECS countries in general suffer from a lack of an economic framework to guide fiscal policy, which as noted earlier, has resulted in debt/GDP ratios in all countries (except for St. Lucia) that are higher than the 60 percent recommended by the ECCB. Detailed country descriptions may be found in Annex A.

### ***Balance of Payments***

The balance of payments information correspond to the preceding points that have been made about these economies, with the OECS countries showing lower ratios of balance of payments relative to GDP than Barbados and Trinidad and Tobago. Please see Annex A, Table 19.

### ***Policy/market Failures***

Some of the key inefficiencies derive from government policies, such as mandatory savings, high reserve requirements, and use of state banks to finance public sector expenditures, and unclear competition policies. Other forms of policy failures are incorporated into the summary of gaps and vulnerabilities below.

### ***Summary of Key Gaps and Vulnerabilities***

The following discussion summarizes the major gaps and weaknesses in the region’s financial sectors on the basis of key intermediating functions, the institutional capacity of institutions to carry out those functions and the quality of the enabling environment and infrastructure within which intermediation occurs.

In collating the findings of the study in this way, it is the intention of the study team to address the factors that affect the performance and functioning of the financial sector.

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<sup>42</sup> Note that exchange rates, included in the Statement of Work, are addressed earlier in this report in the discussion of foreign currency risk management by the banks.

### ***Financial Sector Composition and Structure***

- The banking sector markets in the region are relatively vibrant and established. However, structural conditions, fragmentation of service between the formal and informal sectors, and ownership and risk concentration present formidable challenges to raising the bar of financial intermediation to a consistent international standard of efficiency. Some of the negative conditions are transitory and will disappear with continued reform efforts. Others, if allowed to persist will, undermine economic progress.
- There appears to be a duality in the structure of financial intermediation by banks, depending on their ownership structure and place of origin. Closely held private banks and foreign banks tend to cater to a narrow range of client segments, focusing on relationships based on familiarity and/or serving top-tier companies domestic and international clients. State-controlled banks, particularly in the OECS, are deemed to be the weakest, least commercially orientated, and pose a limitation on long-term development of a number of financial systems. This duality presents a unique challenge in addressing the question of how to catalyze sector development in the region.

### ***Policy/Market Failures***

- Significant inefficiencies in financial intermediation derive from government policies, such as mandatory savings, high reserve requirements, and use of state banks to finance public sector expenditures, and unclear competition policies. These issues are not easily addressed, but they represent a foremost constraint to development.

### ***Weak Bank Governance/Management***

- Transparency and disclosure in the banking sectors in the Focus Countries is barely adequate in respect of ownership disclosure, accounting explanations, and financial reporting. The hurdles posed to obtaining these basic building blocks of information – ownership, complete financial statements, and comparative information – create the impression of a banking culture in which transparency is not highly valued. In the case of credit unions, there are no mandatory disclosure requirements in any of the Focus Countries. In the banking sphere, particularly important challenges are the ability to supervise the multi-country financial conglomerates. The multi-jurisdiction and multi-sector activities of these groups also make it difficult for the market and the supervisory agencies to monitor their activities effectively, which is another aspect of corporate governance.
- Governance of the domestic state-controlled banks presents a source of vulnerability, particularly in the OECS countries where the banks are considered to have weakened themselves due to their overexposure to government securities and government-sponsored projects. This presents a unique challenge in governance and may require separate attention.

### ***Credit Union Vulnerability***

- Credit unions have played an increasingly important role in financial intermediation in all of the Focus Countries, filling gaps in service to the informal sector and underserved areas. However, unchecked growth coupled with under investment in infrastructure poses a risk to sustainability of service. High levels of bad debt and operational inefficiency pose limitations on these institutions. While lack of information on these institutions hindered analysis of their effectiveness in financial intermediation, our on-site work indicated a wide disparity in the level of development of credit unions within and among countries.

### ***Weakness in Regulation***

- As has been analyzed in detail by the IMF and further explored during the course of the study, all of the countries have weaknesses in various aspects of financial sector supervision; these have been analyzed in detail in the IMF reports previously noted.

- In the non-banking sphere, particularly important challenges are the ability of insurance companies and credit unions. There were observed shortcomings in the regulation and supervision of credit unions in most of the target countries. Significant growth in the credit union activity and an increase in their breadth of activity have left many regulatory systems ill-equipped in both policy development and institutional capacity to address the scale of current activity. The challenges vary from the absence of regulation, such as in Grenada, to under-developed regulation, to lack of coherency in regulation from market to market. Lack of information on credit unions across the board, reportedly high delinquency situations in several countries underscores the need to address the situation.
- Regulatory integration across NBFIs is a relatively new approach that has been introduced in a few of the target countries<sup>43</sup> to create some economy of scale in the way various types of institutions are regulated. However, more work needs to be done. The integration efforts appear to have been focused more on achieving economy of scale in the cost of regulating financial services than on the creation of coherent policy frameworks that differentiate the approach to regulation on the basis of public policies and risk. The risk is that regulation across the financial services sphere will be imbalanced. Imbalanced regulation can create distortions in the marketplace that can manifest in both increased risk and under-development of certain sub sectors. These sorts of variances can lead to sub-optimal financial sector performance. The lack of formal regulation of credit unions in spite of their role in lending and savings mobilization is just one example of where coherency in regulation breaks down. The lack of consistent regulation of insurance, another example, impacts the ability of insurance intermediaries to transact across border and spread their own risk.

### ***Vulnerability to Loss of Confidence***

- Three of the six OECS countries (Dominica, St. Kitts and Nevis and St. Vincent and the Grenadines) all have large state-controlled banks, each of which has considerable risk exposure to its government. However, there does not appear to be a sufficiently developed set of contingency plans to address actions to ward off or react to financial crises.
- The OECS does not have any explicit deposit protection mechanisms in place, although Barbados and Trinidad do. OECS depositors, small and large, must either place their money in banks in good faith, assume that the government will guarantee deposits if banks fail, or leave their money in the mattress. This is inefficient; it represents a barrier to the integration of financial markets across the region; it hinders savings mobilization; and it fosters uncertainty among deposits since they have no express assurance that the governments will protect their deposits if a bank fails. The lack of clarity over the extent of government assurances during bank failures can lead to runs on banks and contribute to system-wide instability, which in turn undermines financial sector development and intermediation.
- The extent of risk concentrations across the regional economies, and the inherent vulnerabilities of the small financial systems to external shocks, underscores the need for a crises contingency plan that will set out policies and actions in the event any or all of the island economies face a crises. Contingency plans for response to shocks have not been fully formed.

### ***Barriers to access and inefficiencies in MSE finance***

- There is a widely held view among stakeholders that micro enterprises and, possibly, small businesses are underdeveloped and under financed in the Focus Countries. While there is a dearth of official data on the quantify and scale of financing by these businesses to understand if demand is in fact being met, many of the micro enterprise and small business programs that do exist suffer from a range of shortcomings. These shortcomings invariably impact MSE's use of finance and sustainability. They

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<sup>43</sup> Reforms have followed efforts of other regulators around the world. Integrated regulation has been introduced to varying degrees in the UK, Singapore, Australia, Mauritius, Canada, Korea, for example.

include, among others, the following: structural conditions that fail to provide the appropriate incentives for borrowers or lenders, insufficiently developed policies and controls, appropriate lending technology, high transaction costs, limited product choice, and risk assessment weaknesses.

- The need for domestic and regional credit bureaus was recognized by interviewees in many of the Focus Countries as a way of improving the overall credit environment as small business lending and trade relationships. There is only one domestic operation in the region, Trinidad and Tobago, where the existing credit bureau is constrained by the lack of an appropriate legal and regulatory infrastructure<sup>44</sup>.
- Lack of official data about MSE's, such as their number, size in terms of contribution to GDP, employment figures, growth trends, borrowing, etc. hinder financial institutions that may wish to market to that segment, or assess growth prospects. They have no reliable information on which to plan or design products around.
- Various findings and observations made during the study seem to suggest that more may need to be done in improving both the supply and demand of credit to this segment. Banks and credit unions in a number of countries expressed an interest in providing services to the informal and entrepreneurial segments, but lacked the necessary skills and/or systems to properly manage the risk or questioned the profitability of the activities in relation to administration and funding costs. High unemployment and shifts in the private sector structure to service industries from agriculture indicate that there are opportunities for an expansion in MSE financing that would have a direct and meaningful impact on the business environment.
- Registries for collateral –movable property or real estate - are not sufficiently developed in any country, and in most cases they suffer from one more impediments. Some of the noted weaknesses include the following: complex and outdated registration processes, lack of adequate maintenance of registry operations, public-private duality of property ownership regimes; unclear titling or persistence of multiple property rights, legal and administrative inefficiencies in perfecting, enforcing and/or creating security interests. The upshot of these conditions is that the cost of issuing credit is increased; a disproportionate amount of lending is made on an unsecured – or unconventional – basis; loans are not made; and/or loans are made that should not have been made. Weaknesses also have an impact a broader economic impact. They make it very difficult for merchants who are willing to sell on credit to poor customers with good reputation, to get credit backed by their receivables or inventories. Third, it can hamper the growth of manufacturing or capital-intensive businesses.

## Conclusions and Recommendations for Banks/NBFIs

### Overview

The key strategies and recommendations that respond to these gaps/vulnerabilities are listed and prioritized below.

Recommendation	Target Impact	Targeted Assistance
<b>High Priority – Ready for Implementation</b>		
<b>Broad-based program to strengthen conditions for and improve access to MSE finance</b>	Improved access to and lower cost of finance  Better match of financing	<ul style="list-style-type: none"> <li>• Comprehensive demand assessment of MSE finance</li> <li>• Support for the development of domestic and regional credit bureaus</li> <li>• Expand micro finance outreach</li> </ul>

<sup>44</sup> The activity of this credit bureau, which processes an average of 10,000 credit requests each month, indicates the valuable role that it plays.

Recommendation	Target Impact	Targeted Assistance
	needs of enterprises	<ul style="list-style-type: none"> <li>• Provide assistance to indigenous institutions in developing business models targeted at small enterprise banking</li> <li>• Reform and upgrading of collateral registration system</li> <li>• Generate and disseminate market information on MSE activities</li> </ul>
Support for creation of a coherent framework for regulation and development of NBFIs	Market deepening and opportunities for increased competition  Platform for safe and sound development of NBFIs  Promotion of stability and reduction of systemic risk	<ul style="list-style-type: none"> <li>• Support for development of integrated regulatory frameworks</li> <li>• Support for the strengthening of credit union supervision and regulation in OECS</li> <li>• Broad-based support for the development and strengthening of insurance regulation</li> <li>• Special assistance to financial sector policy makers on structural conditions within and among target countries and sector-wide policies</li> </ul>
<b>High Priority – Implementation Dependent</b>		
Support for strengthening of deposit protection in OECS	Promote confidence and savings mobilization; increase market discipline and efficiency in resource allocation	<ul style="list-style-type: none"> <li>• Viable options assessment, design, international benchmarking, organization, and implementation</li> </ul>
Support for strengthening of public governance and market-orientation of state-controlled banks	Increase market discipline and efficiency in resource allocation  Reduce debt overhang and distortions	<ul style="list-style-type: none"> <li>• Assistance in the restructuring/divestment and workout of state-controlled banks</li> <li>• Assistance in the development of alternative resolution programs for distressed debtors</li> <li>• Assist host governments in creating adequate corporate governance processes for state-controlled institutions</li> </ul>
<b>Constructive – Ready for Implementation</b>		
Support for development of crises contingency framework	Risk reduction	<ul style="list-style-type: none"> <li>• Assistance in development of detailed framework and actions plans for mitigating the impact of financial shocks on the financial sector.</li> </ul>

A discussion of tactics and suggested interventions are provided below.

### **Develop a Broad-based Program of Assistance to Strengthen Conditions for Improving Access to and Use of Formal Finance by MSE's**

USAID has a significant history of addressing MSE finance development around the world, in particular through the implementation of broad-based projects that integrate interventions to address a range of weaknesses existing at one time. As one of the leading donors in these types of interventions, we recommend that USAID develop a multi-part program to strengthen the environment for MSE finance. Key elements of this strategy should address three main goals: first, to improve the infrastructure for finance in ways that lead to more efficiency in the process of providing finance; second, to increase the capacity of the financial sector to meet MSE demand for finance; and third, to develop a base of knowledge on the real sector, its activities, and nature of demand for finance as a means to catalyze coordinated responses from the donor community, NGOs and policymakers. This knowledge would also be instrumental in the design of any additional “next generation” USAID interventions that may be required to address persistent gaps in finance to under-served areas.

Specific assistance in support of this strategy should include the following.

### Comprehensive Demand Assessment/market Survey of MSE Finance

USAID should be effective in leveraging its work in SME and micro finance to quantify and qualify the extent to which the financial markets meet the needs of small enterprises, or not. The findings of a well-executed survey will inform USAID and other donors of the specific needs of MSE's in the region and can serve as an important tool for garnering broad-based donor support to address weaknesses, or replicating strengths in the region<sup>45</sup>. It will also address issues pertinent to the real sector, its borrowing need and product preferences, and where BDS linkages may be needed, etc. These issues are a critical part of the equation in determining where roadblocks to financial intermediation and enterprise credit growth exist. A survey can be an effective tool for assessing demand and pipeline identification. Surveys need to measure perceptions about access to finance as well as experience, and should be combined with findings on a number of variables. Surveys should take into account the different factors that affect different market segments by disaggregating information by female vs. male, rural vs. urban, etc. In USAID's website, in a section entitled "Innovations in SME Finance," there are two tools that serve as a resource for the design of a demand-based survey of MSE finance. One is an SME finance intervention toolkit, which covers some of the issues in assessing demand; the other is a representative scope of work for a demand-based assessment.

While an assessment alone will obviously not increase access to credit, in a fragmented environment, it will be instrumental in helping to focus donor/policymaker efforts and resources in areas of greatest need. If USAID elects to commit funds or guarantees to help subsidize finance to underserved areas, it should do so on the back of a definitive, independent survey of demand<sup>46</sup>.

### Support for the Development of Domestic and Regional Credit Bureaus

The need for domestic and regional credit bureaus was recognized by interviewees in many of the Focus Countries as a way of improving the overall credit environment of small business lending as well as vendor-to-buyer relationships. There is only one domestic operation in the region, Trinidad and Tobago, where the existing credit bureau is constrained by the lack of an appropriate legal and regulatory infrastructure<sup>47</sup>.

We recommend two sequential roles for USAID in furthering the development of credit bureaus: First, assist in strengthening the legal and regulatory framework within which the credit bureaus would operate. Second, facilitate the creation of credit bureaus in Barbados and the OECS.

- *Strengthen the legal and regulatory framework.* The first stage of an intervention would be to strengthen the legal and regulatory infrastructure within which credit bureaus operate. A legal adviser who would work with the Trinidad and Tobago credit bureau and bankers' association to draft the appropriate regulations and laws could accomplish this intervention. These could then be provided to the bankers' associations in the other countries as "best practice" models. Depending on the conditions in each country, either the bankers' association could take responsibility for working with the government to implement the package or the legal adviser could do so.

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<sup>45</sup> USAID's website, in a section entitled "Innovations in SME Finance" contains at least two tools that may serve as a resource for the design of a demand-based survey of SMME finance. One is an SME finance intervention toolkit, which is covers some of the issues in assessing demand. The other is a representative scope of work for a demand-based assessment.

<sup>46</sup> We firmly believe that USAID's most successful small business finance interventions have been those that were first designed on the back of a pre-intervention survey.

<sup>47</sup> The activity of this credit bureau, which processes an average of 10,000 credit requests each month, indicates the valuable role that it plays.

- *Creation of credit bureaus.* There are two alternatives to creating new credit bureaus: (1) expand the Trinidad and Tobago credit bureau or (2) create a separate bureau for Barbados and the OECS. Expanding the existing credit bureaus has the advantage of enabling cross-country exchange of information through a common information technology (IT) system, as well as utilizing a model that has already worked in Trinidad and Tobago. The fact that several large banks from Trinidad and Tobago have operations throughout the region could facilitate the implementation of such a regional approach. If political factors make a regional approach not feasible, then a separate bureau could be created for Barbados and the OECS together, or if more appropriate, one for Barbados and one for the OECS.<sup>48</sup> This intervention could be implemented by assigning a full-time adviser to the bankers' associations of Barbados and the OECS; this adviser would take on the necessary coordinating work, including working with the bankers' associations to determine whether a regional, semi-regional or country model was the most feasible.<sup>49</sup> The adviser's role would be as a catalyst and coordinator; all of the costs of establishing and operating the credit bureaus should be borne by the participants, as has been the case in Trinidad and Tobago.
- An indicative set of activities for intervention may include three phases: *Assessment:* An analysis of demand for a credit reporting system: its users, constraints, and limitations as well as the legal and regulatory framework for both state-sponsored and private initiatives and the enabling environment for complementary credit bureaus. *Design:* Recommendations regarding the structure of a credit information system or systems that would meet the needs of stakeholders within the regional financial system. This would include consensus building. *Implementation:* Assistance with the implementation of a credit-reporting bureau. This may include direct assistance in the form of physical setup and organization of a bureau, facilitation in securing buy in and effort from sponsors, development of regulations, outreach, identification and coordination with international parties.

The development of a credit reporting bureau/system will address a fundamental problem in the credit markets: the asymmetric information between borrowers and lenders that can lead to adverse selection of borrowers, which in turn leads to higher levels of non-performing loans. Reporting enables the evaluation of credit risk in more detail and more accurately, lowering processing time and costs, both in terms of loan management and of the overall cost of non-performing loans in the system. The general goal of all credit registries is to enhance transparency of banking activities and make these activities secure. Credit reporting strengthens borrower discipline since non-payment with one institution immediately results in negative sanctions in other institutions. Improvements in the quality and reliability of data on consumers and small businesses would have a direct impact on the cost and volume of lending.

### **Expand Micro finance Outreach**

Although there is considerable activity in the micro finance market, there is room for more of the “right” kind of activity that would lead to more sustainable micro financing. USAID should contribute to this objective in one or more of the following ways, none of which are mutually exclusive. It should work with proven micro finance providers who need assistance to expand their operations more quickly, achieve consistency with best practices, and achieve sustainability. It should facilitate the entry of new

<sup>48</sup> Economies of scale would indicate that a combined credit bureau would be preferable; however, some further research would be necessary to determine whether there are good business reasons to make this type of information – which concerns relatively small borrowers – available on a regional scale.

<sup>49</sup> If a regional model is deemed appropriate, the adviser could also evaluate the feasibility of eventually including other Caribbean countries (beyond the Focus Countries) as well. While success of the project would presumably dictate against too ambitious a regional scope at the outset, it would be prudent to ensure that the basic model adopted in the Focus Countries does not preclude subsequent expansion to other countries. Note, for example, that Jamaica is in the process of developing a credit bureau; at a minimum the adviser should evaluate the potential compatibility of that bureau with any new bureaus to be developed in the Focus Countries.

micro finance providers through a technical alliance or co-funding partnership in areas, where existing providers are not able to fully service. It should assist commercial banks and credit unions to develop their micro finance operations through technology and knowledge transfer.

- *Proven micro finance providers:* The prime candidate in this category is Caribbean Micro finance Ltd. (Microfin), a micro finance lender based in Trinidad and Tobago. Microfin currently has operations in St. Lucia, Grenada and Trinidad and Tobago. Microfin has stated that additional funding for training would enable it to accelerate its plans to establish a presence in other OECS countries.<sup>50</sup> Microfin's strengths are a commitment to create financially sustainable micro finance institutions; the recognition that sustainability requires a regional approach in order to achieve the necessary economies of scale; and success in creating alliances with experienced micro finance practitioners such as Accion and the IDB, who have assisted Microfin in implementing proven micro finance technologies. As apparently the only credible micro finance provider in the Focus Countries, however, Microfin is also potentially vulnerable to dangerously rapid expansion, as a result of overly enthusiastic donor funding.<sup>51</sup> Therefore, should USAID choose to work with Microfin, careful coordination with other donors will be critical. Further, it should be stressed that, based on research by Microfin, the major micro finance lender in the region, the OECS micro finance markets are quite small, with total demand of under USD 1.2 million per country.<sup>52</sup> Such information underscores the importance of having good underlying data before attempting to assist micro enterprise development,<sup>53</sup> whether by means of micro finance or other interventions.<sup>54</sup> Because of this USAID could also consider focusing its efforts on helping Microfin develop its institutional capacity.
- We note: The National Development Foundations are a potential target for assistance, but more information is needed to determine if they could enjoy sustainable benefit from USAID assistance/partnership. The NDFs in some countries hold significant distressed debt and their sustainability is uncertain.
- *New Entrants/new finance:* USAID is one of the leading donors focusing on linkages between micro finance and the formal financial system as a means of expanding and micro finance capacity and ensuring sustainability. It may be able to find unique leverage in the use of the Development Credit Authority's (DCA) guarantees to secure wholesale bank financing for new micro finance institutions, or develop partnerships with international commercial banks, such as Citibank<sup>55</sup>, to induce new entrants into the market. New lending programs might focus on larger borrowers in the micro finance segment. Design of a "new entrant" intervention could be done as by open invitation to the private sector – NGO and USAID contractor community – to make proposals for public-private partnerships that take advantage of technical assistance support to encourage new investment.
- *Commercial banks and credit unions:* The advantage of commercial bank micro finance programs is that, provided they are commercially attractive to the banks, they have an inherent sustainability and

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<sup>50</sup> Note that Microfin has sufficient funding to finance additional lending on its own.

<sup>51</sup> Note in this regard that DFL, the founder of and strategic investor in Microfin, has recently requested assistance from USAID to expand its micro finance operations into Suriname and Guyana. Also, the CDB advised that it has recently approved funding for Microfin's operations in St. Lucia, St. Vincent and Grenada.

<sup>52</sup> Microfin defines microenterprises in the region as those with 1-2 employees, assets up to USD 10,000 and annual turnover of up to USD 20,000.

<sup>53</sup> Microfin estimates that the micro finance market in Trinidad and Tobago is USD 6-10.5 million and in Barbados approximately USD 7 million.

<sup>54</sup> Note that CIDA and UNDP stressed the need for additional business development assistance in the OECS.

<sup>55</sup> For other countries, Citibank has offered both technical assistance and subsidized guarantees to assist the micro finance institutions in raising wholesale funding for sustainability.

outreach potential that is more difficult for dedicated MFIs to create. Active commercial bank participation in micro finance would also help avoid the creation of a monopolist micro finance provider, which is a possible scenario for Microfin.<sup>56</sup> The obvious challenge is to identify commercial banks with a genuine commitment to micro finance and a willingness to adapt their procedures to correspond with those that have been proven to work in micro finance. Based on the study findings, there is sufficient commercial bank interest in micro finance to warrant an attempt to develop such a program. It is particularly noteworthy that Scotia Bank has had a successful micro finance program in Guyana as well as a joint project with CIDA in Jamaica, RBTT is a shareholder in DFL and Barbados National Bank (BNB) has begun its own group-lending program.<sup>57</sup> While these particular banks all have regional operations or affiliations, micro finance could also be of interest to some of the smaller indigenous banks, assuming that they are able to achieve sufficient economies of scale. Larger credit unions could also be appropriate participants in the program. The commercial bank program would consist of helping banks cross the conceptual hurdle of understanding how a micro finance program can become a relevant part of their business, as well as the cost hurdle of putting an effective program in place. Therefore the assistance would focus on: (1) identifying those banks with a credible commitment to developing a micro finance program, including establishing the criteria for confirming such a commitment; (2) assisting the banks to establish an appropriate organizational structure, (3) and training core bank staff in the appropriate lending methodology. The banks in the region are sufficiently liquid to be able to fund the programs on their own.

#### **Provide Assistance to Indigenous Institutions in Developing Business Models Targeted at SME Banking**

A number of institutions remarked that in spite of interest in the micro enterprise segment, the costs of administration and the related risks of lending made it difficult to justify investment in some cases. In some respects this sentiment also applies to the smaller end of the SME segment – enterprises that may be too large for most micro finance programs, but may be too small for the interest of local banks.

We recommend that USAID provide targeted assistance to a select group of indigenous financial institutions in the business of SME *banking* to help them acquire the skills and a broad understanding of how to approach the SME segment. The recommendation is aimed at addressing a fundamental barrier to SME finance that exists in many developing markets by addressing not just the credit side of the business, but the entire business-approach to serving SME's. It is an approach, which looks at the entire business proposition of providing both credit and deposit services to SME's - leveraging distribution channels and non-credit services to make the segment a profitable one<sup>58</sup>.

This program may involve activities such as the following:

<sup>56</sup> On the other hand, if the micro finance market is as small as USD 1.2 million per country in the OECS, there is not room for more than one provider to serve this market profitably. In Trinidad and Tobago, Microfin's major competitors are NEDCO, a government-funded organization, as well as the commercial banks.

<sup>57</sup> BNB was a majority state-controlled bank until recently, when Republic Bank became the strategic investor. Republic Bank is just in the process of assuming operational control, so it is too early to state whether BNB's micro finance program, which was initiated by its president, will be continued.

<sup>58</sup> On average, in developed economies, only 15 percent of profits from SME banking come from *credit* activity – 85 percent come from deposit services and fee-based services.

- Targeted assistance and training to a select group of indigenous financial institutions in the business of SME banking, providing experts in SME banking strategy development, examining the success of their SME banking programs.<sup>59</sup>
- SME banking forums, bringing together institutions and SME trade associations from the region to address needs and barriers<sup>60</sup>.
- Sponsorship of programs and training on a shared-cost basis through the bankers and credit union associations.
- Creation of toolkits on SME credit and banking for bankers and borrowers.

### **Support for the Creation of Modern, Uniform, Secured Financing System for Movable and Immovable Property**

In recent years, USAID has provided considerable support for the upgrading and improvement of collateral registries and the overall environment for secured transactions (lending and otherwise). Conditions in the region are not optimal for securing, perfecting and enforcing collateral because land registries and movable property registries, where they exist, are not well-designed or supported for use by a modern transaction-oriented financial system. Standards and reforms have been introduced to varying degrees among countries, but there is no harmonization of systems.

We recommend that USAID provide support in at least two ways: First, provide support for the creation of a uniform, regionally integrated framework for collateral registration and secured transactions. Second, country specific assistance in adopting the uniform framework and in addressing issues that are unique to the country's legal and economic structure.

*Creation of a uniform framework:* USAID could field advisors to develop a set of standards, specifications, and best practice templates for secured transactions. The standards would be based on a regional examination of existing registries and securitization practices, and they would include a full package of documentation containing model laws, operational guidelines, information system needs, and an action plan for implementation. The creation of this framework, the “model system”, could be done on the back of existing work in Trinidad, where additional support is needed to fully develop a system that accounts for the needs of modern financial institutions. Trinidad appears to be the most advanced in modernizing its systems.

*Country-specific assistance:* In addition to the creation of standards and uniform codes, there is strong need for targeted assistance to individual countries in helping them to strengthen their collateral registry systems. Such assistance could include direct support in the implementation of reforms, or advisory support along the lines of:

- Development of new legal infrastructure for secured financing. This would include detailed recommendations addressing all aspects of a modern secured financing system including, but not limited to, creation, registration, priorities and enforcement of rights on movable property. It would also need to include any necessary consequential changes to the existing law, including, but not limited, to the Civil Code, the Code of Civil Procedure and the bankruptcy law
- Overview and recommendations for the creation and implementation of modern registry of rights on movable property, which can be accessible from any part of country

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<sup>59</sup> USAID implemented a successful SME banking program in Kosovo involving the greenfield establishment of an SME bank. More on this example can be found on USAID SME finance web site.

<sup>60</sup> A number of studies have been done in Europe on the topic, which would serve as an example of these collective efforts

- Training of local officials, bankers, finance professionals, judges
- Identification and explanation of changes in the existing laws that would allow for a greater variety of interests and transactions
- Increasing the efficiency of enforcement processes. Introducing changes in the law that allows parties to contract for non-judicial repossession and sale or to use alternative dispute mechanisms
- Assistance in the establishment, design and organization of registry operations. This would include development of policies, procedures, and processes for maintenance, validation, security, etc.

An indication of the potential impact modernization of secured transactions regimes can have, is well gauged by reference to a couple of disparate pieces of information on secured transactions in other parts of the world<sup>61</sup>. First, half of all credit in the United States is secured by some kind of movable property: about two-thirds of bank loans are secured by either movable property or real estate. Second, estimates put welfare losses caused by barriers to secured transactions at 510 percent of GDP in Argentina and Bolivia. These numbers speak for themselves in terms of the impact such regimes can have on financial intermediation.

#### **Generate and Disseminate Market Information on MSE Activities**

There appears to be no official data about such MSE businesses, such as their number, size in terms of contribution to GDP, employment figures, growth trends, borrowing, etc. As a result, financial institutions that may wish to market to that segment, or assess growth prospects, have no reliable information on which to plan or design products around. USAID could catalyze the process of information collection, aggregation, analysis and distribution of information on MSE activities by working with banks, government authorities, and other donors to create a common platform or knowledge bank.

#### **Development of a Coherent Framework for Regulation of all NBFIs (Non-bank Financial Institutions) Within and Between Countries in the Region**

While regulation is sometimes seen as a constraint to development, in a global economy where capital flows easily across borders, balanced regulation can help foster development by creating a level playing field and neutralizing the regulatory burden across the sector and in some cases increasing the attractiveness of the market to foreign investors. On the other hand, imbalanced regulation between various financial services industries and among institutions in various countries presents a formidable challenge to safe and competitive financial sector development.

The issues are pronounced in the Caribbean due to geographic disparity and fragmentation in the sector. Uneven development among institutions represents both a threat and an opportunity to financial intermediation. Disproportionate regulation can create distortions in the marketplace that can manifest in both increased risk and under-development of certain sub sectors. These sorts of variances can lead to sub-optimal financial sector performance. The lack of formal regulation of credit unions in spite of their role in lending and savings mobilization is just one example of where coherency in regulation breaks down. The lack of consistent regulation of insurance, another example, impacts the ability of insurance intermediaries to transact across borders and spread their own risk.

USAID is a preeminent provider of long and short-term assistance for the strengthening of regulation and supervision among financial institutions. It can achieve a marked impact on financial sector development

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<sup>61</sup> Taken from a paper published by the World Bank: "Secured Transactions: The Power of Collateral," Heywood Fleisig.

in the intermediate-term by working with governments and institutions on developing the *right* types of regulatory structures so that NBFIs can develop to the needs of the local market. **Such assistance should be not be under weighted in its potential impact on sector development.** This can be seen in the efforts of leading regulators around the world who have initiated sweeping regulatory reforms to eliminate barriers to safe and sound growth of their domestic financial systems<sup>62</sup>.

Regulatory assistance is best provided through long and short-term advisors, who can work alongside counterparts on a daily basis. An important requirement of any program, and one that should be rigorously measured and monitored, is the degree of knowledge transfer that is being achieving from the advisors to the counterparts. The multiple skills required for NBFI regulation, and the degree of discretion afforded NBFI regulators, underscores the need for experiential learning and reliance on a systematic program of leadership training. The program should seek to facilitate consultation with other regulators who recently modernized their systems to address the NBFI development challenge.

High priority areas, which should be incorporated into an intervention, include the following:

#### **Support for Development of Integrated Regulatory Frameworks**

Regulatory integration across NBFIs is a relatively new approach that has been introduced in a few of the target countries<sup>63</sup> to create some economy of scale in the way various types of institutions are regulated (by prudential, market integrity and consumer protection standards). However, more work needs to be done. The integration efforts appear to have been focused more on achieving economy of scale in the cost of regulating financial services than on the creation of coherent policy frameworks that differentiate the approach to regulation on the basis of public policies and risk. The risk is that regulation across the financial services sphere and among countries will be imbalanced, distortionary, and, in turn, counter to good development. Areas where USAID could provide support aimed at strengthening the environment for NBFI regulation should include:

- Work with counterpart staff to define a regulatory philosophy and key objectives for regulation of different types of institutions.
- Develop a framework for regulation of different industries that reflects the regulatory objectives and the amount of risk each industry poses to the system and consumers.
- Identify the preconditions for effective supervision in each industry and ensure that implementing regulations are appropriate for the local legal system and the regulatory framework it supports;
- Systematic knowledge transfer and training to enable regulators to adopt a balanced position as both protectors and promoters of industry development.

#### **Support for the Strengthening of Credit Union Supervision and Regulation in OECS**

While credit union supervision is being reformed in all of the Focus Countries, the only group of countries expressing interest in direct support was the OECS. This recommendation therefore is for USAID to build on existing credit union supervision program by: 1) providing broad-based assistance to countries in the OECS; and/or 2) providing targeted assistance to the CCCU in the regional harmonization of regulations and supervisory practices and for statutory regulators to monitor the quality of self-regulation.

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<sup>62</sup> This includes regulators in Canada, Australia and the United Kingdom, all of whom have noted “industry development” as one of there officially mandated objectives.

<sup>63</sup> Reforms have followed efforts of other regulators around the world. Integrated regulation has been introduced to varying degrees in the UK, Singapore, Australia, Mauritius, Canada, Korea, for example.

- *OECS countries*: The scale and differentiation of the gaps noted among the OECS countries suggests that assistance is needed not only in capacity building, adoption of tools and methodologies, and reporting but also in the development of policy frameworks and regulations. While efforts are being coordinated by both the self-regulatory agencies and regional bodies, there is some variance in how each country addresses the regulatory issues vis-à-vis other financial institutions (banks and other NBFIs) in the home markets. The need for assistance varies. For example, Grenada has no regulations. Other countries have differing requirements on credit unions.
- *Support to CCCU*: While government financial authorities are taking more active responsibility for credit union supervision in Barbados and Trinidad, the current model in the OECS countries emphasizes more self-regulation by the CCCU, with oversight by the ECCB, as well as the ongoing role of supervisory agencies (non-financial) in each country.<sup>64</sup> While self-regulation is a more passive approach to regulation, it is important to ensure that the OECS model is effective in warning against potential failures. Therefore, it is recommended that USAID build on an existing initiative underway by CARTAC, CIDA and several other donors. This would involve short-term projects to strengthen the supervisory capacity of the CCCU and develop the ECCB's ability to exercise oversight over the CCCU's activities. 18 credit unions in the region, all of which have hired professional management as a condition for participation, would take part in the program, as will the six national leagues. USAID could extend this initiative by lengthening the duration of the project being sponsored by CARTAC, as well as possibly its scope to include more work on reporting and disclosure, creation of regulatory chart of accounts, corporate governance, etc. USAID could also increase the number of supervisors being trained (the current program trains two supervisors) as well as help to develop the liquidity facility contemplated for the CCCU.<sup>65</sup>

### **Broad-based Support for the Development and Strengthening of Insurance Regulation**

While the study only covered a limited review of the insurance industry and its regulation, developments in the industry, as well as an increase in merger activity among banks and insurance companies, has elevated the importance of achieving regional harmonization and international compliance in regulation. The impact of improved regulation on financial intermediation is indirect. However, if insurance companies are not credibly regulated, they cannot adequately cooperate with other institutions across the region and abroad in sharing risk, distribution, or product development. In a region where risk concentration and lack of diversification opportunities represent a formidable barrier to economic development, this type of intervention should be seen as a priority in ensuring that the insurance industries can fulfill their roles as intermediaries.

USAID should play a role in sponsoring long or short-term programs to strengthen regulation of these institutions; providing direct assistance to regulators, assisting in the development of an indigenous base of professionals that support insurance (actuary, assessor, valuation specialists), and helping to forge technical cooperation links with US-based institutions, such as the NAIC (National Association of Insurance Commissioners). Some additional programs may include providing training in international standards and practices, and coordinating the implementation of an annual market conference that would bring regulators and practitioners together to discuss relevant issues.

<sup>64</sup> DTT understands that the possibility of putting credit unions under the supervision of consolidated supervision units to be located in each country, which would regulate a range of non-bank financial institutions under the direct supervision of the ECCB, is being evaluated. However, this would require legislative approval by each OECS country and is therefore a lengthy process.

<sup>65</sup> USAID could also consider extending any work done on the liquidity facility to other credit union apex organizations in the region.

The scope of potential support from USAID is wide and could include some of the following: alignment of accounting and auditing principles and practices for insurance companies to international standards; development and implementation of a risk-sensitive early warning system to identify troubled insurance companies akin to an early warning system; development of efficient rate approval systems; development of minimum disclosure standards and rules governing insurance holding companies, affiliates and subsidiaries; design and development of a policyholder protection plan (insolvency guarantee funds); survey of risk management practices and internal control systems in the insurance companies; strengthening of mechanisms for the liquidation of insolvent insurance companies; development of a sound enforcement infrastructure, training in solvency regulation, financial analysis and field examination, pricing of insurance products; training for research personnel in finance, actuaries, economists, regulatory specialists, and statistical analysts; development of auditing manuals for the insurance accountants; workshops and seminars on special technical issues, building efficient insurance intermediary systems and self-regulatory practices; design and implementation of testing, certification and licensing programs for professionals in insurance regulation and industry supporting professions (actuary, valuation, assessor); development of corporate governance standards for the insurance companies; development of a regulatory framework (licensing, capital adequacy and professional requirements, etc.) for non-traditional channels of product distribution such as *Banc assurance* and MFIs; design and implementation of a nationwide program on increasing risk awareness of potential consumers; development of regulatory framework for new insurance products that respond to the needs of the vulnerable groups; building insurance education, research and training networks.

#### **Special Assistance to Financial Sector Policy Makers on Structural Conditions Within and Among Target Countries and Sector-wide Policies.**

In the course of the study, a number of areas were identified where target country governments may require assistance in the course of reforming their financial sectors. Many of the issues derive from public policy considerations and may not be part of large-scale interventions currently being addressed. Further, their impact on financial intermediation and the business environment are often over-looked by current donor-funded programs. Some the key areas that we believe should be incorporated into a broad-based intervention are:

- Strengthening of competition policy to address monopolies and other issues stemming from the ownership concentrations among a number of the region's key banks: These consolidated entities and their closely affiliated – sometimes family-owned – structures need to be examined for both risk concentration, financial position, and market power. The influence of consolidated economic power may be one of the leading factors standing in the way of broad-based development in the region. Lack of disclosure makes it difficult to tell.
- Regulatory framework for consumer protection: Many of the target country regulatory frameworks stem from a prudential or market integrity-focused approach to regulation, which fails to address the consumer confidence issues that can be a factor in making or breaking a market. Consumer confidence is very important for market stability and keeping costs of intermediation low.
- Fostering regulatory cooperation across countries in the region to include LACs: The presence of large foreign banks underscores the need to monitor the quality of regulation by home country regulators. If substantial domestic savings is at risk, this vulnerability could serve to drag on market confidence.
- Addressing issues related to the WTO accession of financial intermediaries.

USAID could play a role in staffing short-term advisors to assist the government in addressing some of these issues. It would serve to provide ad hoc, but constructive assistance in areas where weak or ill-informed policies can have a burdensome impact on the quality of financial intermediation and by extension the business climate.

### **Technical Assistance to OECS Countries in the Evaluation, Design and Implementation of Deposit Protection Mechanisms**

The lack of clarity over the extent of government assurances during bank failures can lead to runs on banks and contribute to system-wide instability, which in turn undermines financial sector development and intermediation. We recommend that USAID provide support to OECS countries in the evaluation, design, and, if feasible, implementation of deposit *protection* arrangements for depositors of domestic banks. Deposit protection is not limited to deposit insurance, but can include other forms of protection, such as through legal protections for deposits in insolvency proceedings. While deposit insurance is the most popular form of deposit protection, it should not be implemented if it cannot cover most banks in the system. More importantly, conditions for implementation are not likely good if systems are dominated by a large number of weak state-controlled banks. Nevertheless, some form of deposit protection should be instituted in order to: a) infuse some market discipline in the local system; b) place a cap on the extent of government assurances in the event of bank failures; c) limit the extent of protection to only small depositors. This will induce demand for better information and transparency in reporting by banks and other deposit takers, which will have positive spillover affects in the economy.

USAID has sponsored a number of programs all over the world to implement deposit insurance systems in developing markets. The aim of such as intervention would likely have three phases:

- Country assessments of safety net extension from the point of view of: suitability, design, efficiency, and breadth of coverage, regulation and governance. Assessment of the suitability of depositor protection arrangements for the market and a review of viable options for depositor protection (insurance, priority of depositor claims, limited government guarantees, industry cross-guarantees, etc.)
- Support for the best practice design and development of deposit protection schemes. Assistance in the design of depositor protection mechanisms.
- Assistance in the implementation of a depositor protection mechanism, which would include operational, legal, policy-based assistance, and improving the coordination between regulators and overseers of the depositor protection system (if different).

While express, limited deposit protection schemes have their own pitfalls, they are generally regarded as a better alternative to open-ended state guarantees and can have a strengthening effect on local banking systems. In our consultations with the ECCB, there was some reluctance to address the issue of protection since the state controlled so much of the sector. However, we believe that more needs to be done on this issue as a basis for putting the OECS on a stable footing for growth.

### **Support for the Development and Implementation of Contingency Planning Frameworks that Allow Countries to Respond Effectively to Financial Shocks and Crises**

Governments around the world are beginning to recognize the devastating impact banking crises can have on the overall financial sector, particularly where the initial responses to a crisis are late, weak, inconsistent and/or poorly communicated. The extent of risk concentrations across the regional economies, and the inherent vulnerabilities of the small financial systems to external shocks, underscores the need for a crises contingency plan that will set out policies and actions in the event any or all of the island economies face a crisis. USAID could play a role in assisting in the design of an overall contingency plan that set out policies and procedures to be adopted by the relevant authority to: address the safety and soundness of the financial system; identify potential liquidity, solvency and management issues early; anticipate and resolve policy issues; define and communicate viable, credible plans to avoid

crisis management; segment potentially troubled institutions according to areas of risk and structural supports.

Initially, such a plan should commence with setting a strategy and putting together a policy framework to segment potentially troubled institutions according to areas of risk and structural supports. Thereafter, an assessment would need to be conducted of the individual institutions within the country or region. A comprehensive framework covering business, risk management and sustainable viability would need to be crafted. After the assessment, a decision process framework would be established which would attempt to anticipate a range of scenarios and conditions for a number of possible authorized institutions. The decision process must anticipate incremental degrees of subsequent action, increasing in severity, ultimately resulting in appointment of a manager and, potentially, closure. Finally, an implementation plan is prepared which must include concrete and achievable tasks, and that are congruent with the conceptual framework.

#### **Multi-faceted Support for Strengthening the Public Governance and Market-oriented Influence of Indigenous State-controlled Banks**

While the reform of state-controlled banks is perhaps one of the most challenging issues facing several of the OECS countries, it is an essential condition for sustainable financial sector development. Weak or improperly governed banks represent a counterweight to development and are a systemic threat to market confidence in general. We understand that issues with state-controlled banks are often both politically and institutionally driven. In this light, the viability of these recommendations rest on the will of the home country governments and the ECCB.

USAID could engage each of the host country counterparts with a multi-part program of assistance to expedite restructuring and governance reform. This program should focus on achieving one or two aims: modernization and political independence of the banks; or ring-fencing the bad assets and non-commercial operations of the banks such that they do not distort conditions in the overall market. As an entry to this kind of support, USAID could place one or two top bank policy advisors to work with policymakers in implementing assistance in one or all of the following areas:

- Assistance in the restructuring/divestment and workout of state-controlled banks: While governments of the target countries have a number of intermediate and long-term plans to privatize their state-controlled banks, weaknesses in the credit environment and overall operating environments of these banks suggest that some fundamental restructuring and commercialization will be needed to make privatization successful. In drawing from USAID's long experience in privatization through the 1990's, in Central Europe and elsewhere, it should lend support to assisting home country governments in designing, planning and implementing restructuring and privatization programs. Types of assistance should include: assistance to policymakers on developing and evaluating viable options for privatization, assistance in policy development related to privatization, developing roadmaps for privatization, advisory assistance on operational and financial restructuring, provision of specialized advisors to assist the government in liaising with investment banks and other advisors, advice on the preparation of offering documents.
- Assistance in the development of alternative resolution programs for distressed debtors: A number of countries have large debt burdens that pose a significant barrier to financial sector development. While much of the debt is agriculture and/or public sector related, support is needed in helping banks and credit unions to resolve the bad debt issues. Slow court processes, ineffective insolvency systems, or fear of exposure can lead institutions to forbear on taking actions against troubled borrowers. Forbearance may be the only choice that institutions have if they have no reasonable chance of near–

term collection of loans. USAID should play a role in the development of alternative dispute, or mediation, mechanisms for troubled lending relationships<sup>66</sup>.

- **Assist host governments in creating adequate corporate governance processes for *state-controlled institutions*:** The governance of a state-controlled institution requires a different structure and a different policymaking framework than a privately owned institution. State-controlled institutions are usually held to a higher level of accountability to social development and political agendas than for profitability or service. In a number of countries that are dominated by state-controlled institutions, financial sector development will be directly linked to how well the state-controlled banks are governed and how accountability is measured. To the extent that host governments have the will, USAID can be instrumental in helping to create public sector governance regimes that help to measure and monitor the performance of state-controlled institutions that create incentive compatible mechanisms for inducing those institutions to operate efficiently<sup>67</sup>.

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<sup>66</sup> The Jakarta Initiative Task Force is one example of a program run by USAID, which focused on the development of market-driven mediation services to help banks, and borrowers workout troubled loans without having to go through the courts or use formal insolvency measures.

<sup>67</sup> There are a number of precedents for this type of intervention. In China, for example, where state-controlled institutions dominate much of the system, new governance structures are being examined to assess institutional performance against private sector criteria.

## Prioritization and Factor Analysis of Recommendations for Financial Sector Development (Banks and NBFIs)

Strategy/ Recommendations	Priority & Sequencing	Potential Strategic Impact	Market Segments Most Affected	Technical Needs	Political Will/ Change Agent	Risks
<b>FINANCIAL SECTOR – BANKS/NBFI</b>						
<b>Strengthen conditions for and improve access to MSE finance</b>	High – immediately implementable	Greater capital allocation for MSE development will lead to more economic diversity, growth, and resilience in employment base – all critical goals for the target countries.	Micro enterprises, SME's in both rural and urban areas. Middle market consumers will benefit from uniform credit reporting.	Short-term assistance in SME finance assessment and bank capacity building. Long-term assistance in MSE finance expansion. If warranted by a demand assessment, USAID may consider direct MSE credit funding. In this case, rural finance expertise will be needed.	Strong/Banks, credit unions, business promotion policymakers	Externalities associated with the fragile economic environment could impair progress. Weak credit quality of MSE's requires a long-term financing subsidy from donors.
<b>Support for the creation of a development-oriented NBFI regulatory framework</b>	High - immediately implementable	Appropriate calibration of regulation will support safe and sound development across the sector; it will reduce regulatory arbitrage; over time it will improve competition and lower costs.	Consumers of non-bank financial services. Banks will benefit from a more level playing field. Certain NBFIs should benefit from reduced regulatory uncertainty and increased investor confidence.	Intermediate-term assistance required by individual experts in: insurance, credit unions, finance company operations, collective investment schemes, broking and dealing, and other NBFI activities.	Unclear/Financial regulators, CCCU, CARTAC, ECCB and SRO's	Political will is untested. Public policy agendas could influence treatment of different NBFI industries. Countries lack skill and experience to put frameworks into practice.
<b>Support for strengthening of public governance and market-orientation of state-controlled banks</b>	High – immediately implementable	As state-banks are the main pillar of some financial systems, improved governance and restructuring will lead to better resource allocation, more confidence in the financial system, and more efficiency.	Consumers of financial services	Short-term assistance needed in corporate governance. Intermediate-term assistance needed in bank restructuring and privatization.	Unclear/ State banks and home country governments	Resistance from state-controlled banks. Lack of political wills if magnitude of restructuring affects too many jobs or fiscal position.

Strategy/ Recommendations	Priority & Sequencing	Potential Strategic Impact	Market Segments Most Affected	Technical Needs	Political Will/ Change Agent	Risks
<b>Support for strengthening of deposit protection in OECS</b>	High – Partially implementable, but deposit insurance not advisable for state banks w/o restructuring.	Well-designed deposit protection in OECS will facilitate savings mobilization, leading to closer harmonization with other countries in region, and strengthen market discipline.	Small depositors and households. States could benefit. However, to the extent that the states finance themselves through state-controlled banks, protection may increase the cost of deposit funding.	Short-term expertise in deposit protection design, bank resolution frameworks. and banking law. Possible need for insolvency system specialist and deposit insurance scheme operations.	Unclear/ECCB, Secretaries of finance	Weak state of financial institutions may undermine credibility of any protection arrangements. May take time to get legal arrangements in place; technicality of topic could require substantial inter-government consultation. Banks may resist.
<b>Support for development of crises contingency frameworks</b>	Constructive – immediately implementable.	Impact on intermediation is indirect, but will lead to a more stable and measured response to shocks. This in turn can reduce uncertainty and strengthen the investment and business climate.	Institutional investors and business at large	Short-term expertise needed by a financial sector policy advisor and professionals with experience in financial sector restructuring.	Strong/ ECCB, Secretaries of Finance	Implementation of the frameworks could fall short against political expediency

## CAPITAL MARKETS ASSESSMENT

The four capital markets reviewed in this report are those of Barbados, Trinidad and Tobago, Jamaica, and the OECS. Barbados, Trinidad and Tobago and Jamaica each have its own stock exchange, while the OECS created its own regional exchange (the Eastern Caribbean Securities Exchange – ECSE) in 2001. This report discusses the operational viability and financial sustainability of the individual small markets as constrained by (i) a lack of listed uses, (ii) a lack of a diversity of issues, (iii) a small number of market intermediaries, and (iv) a regionally pervasive “buy and hold” investor strategy. These problems are compounded by individual markets’ varying levels of non-compliance with generally accepted international standards that result in operation anomalies among the individual markets. The recognition of these major themes are key in the development of recommendations to address the issues required to assist USAID in determining the possibility of future interventions in the sector under its current strategy and future strategy.

This section addresses the following:

- The relatively small size of the capital markets and its implications;
- The current status of the region’s securities exchanges, gaps and vulnerabilities, and various issues such as compatibility of their trading platforms, clearing and settlement, and overall compliance with international best practice; and
- Recommendations and interventions

### Overview

#### ***Small Market Comparison***

In order to benchmark the Caribbean markets’ performance a similar small market group (SMG) of capital markets was created. The SMG consisted of capital markets whose geographic size, population and economies were similar to those in the Caribbean assessment group. Countries in the SMG included Cyprus, Malta and Slovenia. The primary similarity utilized in the construction of the SMG was population. The combined population of countries in the Caribbean Group is 4.6 million and 3.1 million in SMG countries.

In order to survive and grow, markets in the SMG have adopted a proactive approach to increasing the number and types of security issues listed and the number of market intermediaries. The overall economic effect of the SMG’s approach is illustrated by the fact that although the combined population of the SMG countries is 49% less than the Caribbean market group, the SMG’s combined GDP is 36% larger and its combined Market Capitalization is 111% larger. The SMG has 267 more listed issues than the Caribbean market group and 42 more market intermediaries.

Country	GDP (US\$)	Population	Issues Listed	Brokers	Market Cap (US\$)
<b>Small Market Group</b>					
Malta	5,600,000,000	400,420	129	20	6,546,072,958
Slovenia	22,900,000,000	1,935,677	105	27	13,054,059,254
Cyprus	10,500,000,000	771,657	144	24	5,064,100,500
Totals	39,000,000,000	3,107,754	378	71	24,664,232,712
<b>Caribbean Group</b>					
Barbados	4,000,000,000	277,264	27	6	3,254,551,112
Eastern Caribbean	3,567,000,000	540,080	7	7	115,154,679
Jamaica	10,000,000,000	2,695,867	48	10	3,187,135,970
Trinidad & Tobago	11,100,000,000	1,104,209	29	6	5,125,406,836
Totals	28,667,000,000	4,617,420	111	29	11,682,248,597

\*\* Market Cap includes each exchange's domestic, home-listings only. The Market Cap does not include an exchange's cross-listed issues. The inclusion of an exchange's cross-listed Market Cap artificially inflates each exchange's actual Market Cap by including one cross-listed issue multiple times. Cross-listed issues' Market Cap is included one time only as part of the issue's home market.

Table 21 below compares the capital markets of the Focus Countries with those of a group chosen because of its similar population size. The table highlights one of the key characteristics of these capital markets: they are small. Even compared to small market group, the market capitalization/GDP ratio of 41 percent in the Focus Countries compares unfavorably to 63 percent in the comparison group.

The reasons for the small size of the region's capital markets have an iterative quality. Because the markets are small, there is limited competition among investment banks, resulting in only a narrow range of debt and equity products. These are of limited interest to issuers and investors – particularly to investors outside the region – the result of which the markets stay small. The smallness of the markets also limits trading hours and contributes to the illiquidity of securities (as can be seen in the trading value figures below), which again limits interest in the markets. It should also be emphasized that the main product traded on the exchanges is equities: Trinidad and Tobago and Barbados have no listings of fixed instruments, the ECSE lists three, and the Jamaica Securities Exchange lists ten, none of which trades. The majority of government debt is traded over the counter. Not only are there few debt issues, but the range of hybrid instruments that is constantly evolving in more developed markets are almost entirely absent.

**Table 21 Caribbean Capital Markets vs. Small Market Group**

Market	Domestic Market Capitalization (US\$)*	GDP** (US\$)	Domestic Market Capitalization Percent of GDP	Issues Listed	Trading Value (US\$) ^	Trading as Percent of GDP	Population
<b>Caribbean Group</b>							
Barbados *	3,254,551,112	4,000,000,000	81.36%	27	10,200,000	0.26%	277,264
Eastern Caribbean #	115,154,679	3,567,000,000	3.23%	7			540,080
Jamaica	3,187,135,970	10,000,000,000	31.87%	48	153,200,000	1.53%	2,695,867
Trinidad & Tobago	5,125,406,836	11,100,000,000	46.17%	29	173,800,000	1.57%	1,104,209
Totals	11,682,248,597	28,667,000,000	40.75%	111	337,200,000	1.34%	4,617,420

Market	Domestic Market Capitalization (US\$)*	GDP** (US\$)	Domestic Market Capitalization Percent of GDP	Issues Listed	Trading Value (US\$) ^	Trading as Percent of GDP	Population
<b>Small Market Group</b>							
Malta	6,546,072,958	5,600,000,000	116.89%	129	47,900,000	0.86%	400,420
Slovenia	13,054,059,254	22,900,000,000	57.00%	105	1,526,000,000	6.66%	1,935,677
Cyprus	5,064,100,500	10,500,000,000	48.23%	144	673,500,000	6.41%	771,657
<b>Totals</b>	<b>24,664,232,712</b>	<b>39,000,000,000</b>	<b>63.24%</b>	<b>378</b>	<b>2,247,400,000</b>	<b>5.76%</b>	<b>3,107,754</b>
* Removing the Eastern Caribbean from the Caribbean statistics raises the remaining group's percentage from 40.75% to 46.08% # Removing the Eastern Caribbean from the group statistics raises the percentage from 40.75% to 46.08% ^ Source: CIA Factbook 2002							

Table 22 below provides additional background showing the number of brokers in each country as well as the number of cross-listed issues. (By contrast, there are 71 brokers in the comparison group.) This information adds to the overall picture of the small size; it also illustrates the relatively limited regional integration of these markets.

**Table 22: Brokers and Cross-listings**

	No. of brokers	No. of cross-listings
Barbados	5	5
Eastern Caribbean	7	0
Jamaica	10	3
Trinidad and Tobago	6	5
<b>Total</b>	<b>27</b>	<b>13</b>

The small size of the region's capital markets creates two major shortcomings in terms of economic development. First, it prevents companies from reaching their optimal size: (1) companies cannot readily grow by raising new equity; and (2) debt may be more expensive than necessary because the capital markets do not provide sufficient competition to the banks. Because banks cannot readily increase their capital, the limited growth that can take place is debt-financed, which can lead to over-leverage. Debt also has the disadvantage of requiring regular interest and principal payments, while equity can provide a cushion in weak years, as the company has the option of not paying dividends. The problem with higher than necessary interest rates is that it cuts into profits, which in turn cuts into growth. Although the common wisdom in the Focus Countries is that the many closely-held family companies are not interested in giving up the confidentiality and control that they maintain over their businesses, increased use of capital markets – and increased openness – can sometimes result in beneficial changes in a company's operations, such as increased efficiency and more rapid responses to competition. Therefore the owners of these companies could find that the advantages of more active use of the capital markets could outweigh the disadvantages.

A second shortcoming of the small size of the capital markets is that it does not allow sufficient risk diversification opportunities for investors. Many of the listed securities are not actively traded, so even within one market an investor cannot necessarily buy or sell at will. In addition, there are limited opportunities to achieve diversification in terms of country risk or product.

## Trading Systems

The automated trading platforms in Jamaica, Barbados and Trinidad and Tobago are all based on the same internationally compliant EFA Technology Ltd. software and are therefore mutually compatible.

Jamaica implemented its Sunrise trading platform in January 2000; it is based on EFA software with modifications for the JSE's requirements. Barbados already utilizes the Horizon trading system (developed by EFA<sup>68</sup>) and Trinidad and Tobago has scheduled full implementation for the first quarter of 2004.

The ECSE utilizes the Open Global Electronic Transactional System (OpenGETS) for its trading platform.<sup>69</sup> This is also an internationally compliant system that is used by exchanges in Colombia, Costa Rica, Uruguay and Venezuela. This system does not automatically interface with the other trading systems in the region.

## Clearing and Settlement

Consistent with their use of EFA software for their trading platforms, the stock exchanges of Jamaica, Barbados and Trinidad also have an EFA system – Equator – for their settlements. (As noted above, Trinidad and Tobago is in the process of implementing the new systems.) Equator is compliant with international standards, but has one noteworthy weak point: an inability to calculate accrued interest. The basic lack of the Equator's ability to calculate accrued interest simply means it cannot settle fixed income trades. The inability to settle such trades, especially government securities, constrains the overall operation of a securities market. It also means that fixed income instruments cannot be listed and traded on an exchange, which drives this business into a non-transparent OTC market. Market data is not readily available and with the subsequent lack of real market data it is difficult to construct a yield curve. It is also difficult for investors to obtain accurate and timely price information, which is vital to an investor's formulation and implementation of an investment strategy. The lack of an open bond market encourages corporations to rely mostly on banks to meet their financing needs. The Jamaica Central Securities Depository (JCSD) had concluded that the Equator settlement system is inadequate to meet its current and future needs and, with technical assistance from USAID, is in the process of evaluating alternatives.

The Eastern Caribbean Central Securities Depository (ECCSD) uses Global CDS software for clearing and settlement; this is a small boutique system developed by Global Capital Market Corporation that is not fully compatible with international standards. As a result, the ECCSD faces the challenge of either upgrading this system or acquiring a new one, in addition to developing operational integration with the other depositories in the region.

## Settlement cycle

With the exception of Barbados, all of the depositories have internationally compliant settlement cycles of T+3. The settlement cycle in Barbados is T+5, which is not internationally compliant. There are two constraints to shortening this settlement time; one is the need to immobilize physical securities, which is currently in process. The other is the fact that each transfer of securities ownership has to be accompanied by a transfer form that includes the signatures of the seller and buyer and a guarantee of the seller's signature by an exchange member.

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<sup>68</sup> The Horizon system was developed by EFA Software Services Ltd. of Canada and is licensed by Computershare Markets Technology of Australia.

<sup>69</sup> This system was developed as a joint venture between the Electronic Stock Exchange of Chile, SUN Microsystems and Nasdaq International Market Initiatives (NIMI), a Nasdaq subsidiary.

Currency conversions and transfers are handled by facilitating banks. These are institutions having a presence in all market countries and will, for a fee from the brokers, handle FX transactions and money transfers. There are many ways around multi-currency problems such as: (i) RSE chooses a single currency to trade in (Euro, USD, etc.), (ii) orders are displayed in multi-currency and, (iii) settlement payment from a buyer and to a seller is calculated by the depository with moneys owed or due being communicated to both parties.

## **Types of Issues**

The issuance of securities instruments in the Caribbean is almost entirely confined to equities. Currently, of the 119 issues available for trading in the region only 16 are fixed income. The concentration of equity issues, with the consequential lack of fixed income issues, has resulted in a lack of market breadth, which is not attractive to domestic and international investors. In order to attract significant amounts of investor capital, the securities market must offer a wide variety of investment instruments to meet the divergent investment needs of the largest number of investors.

A simple but effective analogy in assessing capital markets is to view a securities exchange as a retail store. In order to be successful a retail store must attract customers and a key element in attracting customers is to offer the largest selection of products at the most attractive prices. A securities exchange that offers a limited selection of merchandise, i.e. equity securities, at unattractive prices, will not be in business for very long. A focus on equity issues limits a securities exchange's ability to offer an attractive variety of products since equity issuance is limited, for the most part, to one issuance of common shares or ordinary shares per issuer with a limited additional issuance option of one or two preferred instruments. A limited product selection, in turn, cannot attract and retain a sufficient number of interested customers, i.e. market intermediaries and individual investors. In the capital markets a lack of investors and market intermediaries to service investors, leads to a lack of liquidity, which is usually defined as the number of willing buyers and sellers in the marketplace.

In a region such as the Caribbean, where the number of actual and potential issuers is small, a concentration on equity issuance severely limits the number of issues or investment products available to potential investors.

## **Market Intermediaries**

The small number of issues and the limited variety of issues currently available in the Caribbean has historically led potential international investors to ignore the region in favor of the more diverse and more liquid markets of Mexico and Latin America.

Due to the limitations of geographic size, population and actual/potential equity issuers, the recommended path to diversity and liquidity is the issuance of fixed income instruments. In order to increase the issuance of fixed income instruments, a regional credit agency is required and it is recommended that such an entity be developed and implemented.

Market intermediaries play a vital role in mobilizing capital in financial markets. A key role of market intermediaries is the provision of liquidity by trading for their own account and for the accounts of their clients. A capital market without a sufficient number of market intermediaries lacks capital momentum and will tend towards stagnation. Additionally, a capital market lacking market intermediaries to supply and support liquidity will not be capable of attracting and retaining reasonable levels of investor capital.

The Caribbean markets do not have a sufficient number of market intermediaries to effectively mobilize available capital. The lack of market intermediaries is illustrated by the comparison, below.

### Comparison – Market Intermediaries: Caribbean versus SMG

Caribbean Markets	Market Intermediaries	SMG Markets	Market Intermediaries
Barbados	6	Cyprus	20
Eastern Caribbean	7	Malta	27
Jamaica	10	Slovenia	24
Trinidad & Tobago	6		
<b>Total</b>	<b>29</b>	<b>Total</b>	<b>71</b>

In order to increase the number of market intermediaries in the Caribbean, it will be necessary for securities exchanges and market regulators in the region to provide incentives for current and potential market intermediaries. Incentives may be provided in the form of more attractive commission structures, tax incentives and market maker opportunities.

Based on practical principles of fair competition, securities exchanges and market regulators in the region should consider granting limited trading privileges to domestically registered but foreign-owned trading companies.

#### Buy & Hold Strategy

Historically, investors in the Caribbean region have consistently adhered to a buy and hold investment strategy. In conjunction with the small number of issues available in the markets, the buy and hold strategy has constrained liquidity by keeping tradable shares off the open market. A veritable “logjam” of investor-held securities has developed which has reduced the supply of investment product. Adherence to this strategy has also acted as a barrier to the development of a retail investor market due to lack of securities available in the marketplace.

In order to address the liquidity problems that are thus created, the generally accepted international standards recommend that securities markets implement a well regulated Securities Borrowing and Lending Plan (Securities Borrowing). Implementation of such plans breaks the “logjam” by permitting market intermediaries to borrow securities from held positions to trade in the marketplace.

Market Regulators establish basic requirements for the borrowing and lending of securities with borrowing and lending transactions being monitored by a market’s CSD. Lenders of securities may choose to adopt basic standards, as established by Market Regulators or may wish to set standards that are over and above the basic requirements. Additionally, securities lenders may wish to establish credit criteria that are specific to individual borrowers.

#### System Deficiencies

Markets in Barbados, Jamaica and Trinidad & Tobago have acquired trading software and depository software developed by EFA Software Services Ltd. of Canada and currently licensed by Computershare Markets Technology of Australia.

The Horizon trading software does not pose a major problem. However, the Equator depository software lacks the capacity to calculate accrued interest for fixed income transactions. The inability to calculate accrued interest represents an impediment to the efficient and cost-effective settlement of fixed income transactions.

Technical assistance will be required to assess the Equator system's suitability for fixed income settlement in the Caribbean region, the financial practicality of implementing enhancements to the system or the procurement of a suitable replacement settlement system.

### Depository Risk Management

Markets in the region do not support settlement guarantee funds. Such funds are a key element in the effective Risk Management of the settlement process. A settlement guarantee fund provides assurance to market participants that final settlement will take place even in the event of securities fail or cash fail. In order to inspire confidence in the market it is critical that a single transaction failure not disrupt the continuity of the settlement process. In markets without the benefit of such funds it is possible for a single failed transaction to spill over into the general market and disrupt the entire settlement process.

Trinidad and Tobago does have a contingency fund to be utilized in case of a participant's default, while Jamaica Stock Exchange has a compensation fund that indemnifies losses to members' clients under certain circumstances.

### Regulatory Reform

Market regulators in the Caribbean, as independent entities, are relatively new and in recent years, Caribbean securities markets have made considerable progress in attaining reasonable compliance with generally accepted international standards. However, there are anomalies between individual markets as to the level of compliance and the methodologies used to attain compliance. In order to provide sustainable and transparent evidence that a consistent level of reasonable compliance exists between individual markets, a standardized Statement of Compliance is required. Individual regulatory agencies do not have the full knowledge or experience to regulate securities markets that are compliant with international standards.

There are many areas in which the region's regulators require training. A number of these areas are contained in **Appendix B Caribbean Securities Markets – Compliance Statement**. In many cases individual securities markets do have adequate resources for regional integration and codification of existent regulations.

International investors will require clear and unambiguous evidence that each component of the regional securities exchange meets generally accepted international standards as recommended by:

- The International Organization of Securities Commissions (IOSCO)
- The Committee on Payment and Settlement Systems (CPSS) of the Group of Ten (G-10) Central Banks
- The World Federation of Exchanges (WFE)

Issuance of the regional securities market's Statement of Compliance will require that each individual market's governance, trading operations, business by-laws, settlement conventions as well as regulatory oversight and compliance are benchmarked against international compliance standards. Areas not attaining a reasonable level of compliance must be corrected and a clear and concise Compliance Statement created.

It is also extremely important to note that individual markets participating in the regional securities exchange must be compatible in their governance, operational and regulatory regimes prior to commencing regionalization. The integration of dissimilar markets will, categorically, not work.

## Summary of Gaps and Vulnerabilities

### **Market Underdevelopment**

- The capital markets of Barbados, Jamaica, the Eastern Caribbean and Trinidad & Tobago (the Markets) are, individually, small and illiquid. The operational viability and financial sustainability of the individual markets is constrained by a: (i) a lack of listed issues, (ii) a lack of a variety of issues, (iii) a small number of market intermediaries and, (iv) a regionally pervasive “buy and hold” investor strategy. The regions’ exchanges need to enhance their individual operating profiles and provide incentives for new intermediaries to enter.
- Caribbean securities markets have made considerable progress in attaining reasonable compliance with generally accepted international standards. However, there are anomalies between individual markets as to the level of compliance and the methodologies used to attain compliance. Broad-based, multi-country assistance is needed to coordinate compliance efforts. In many cases individual securities markets do not have adequate resources for regional integration and codification of existent regulations. There are many areas in which the region’s regulators require support in both achieving compliance with international standards *and* harmonizing practices and standards across markets in support of regional integration. A detailed list of these areas is contained in **Annex B** - Caribbean Securities Markets: Compliance Review.
- If allowed to operate under the status quo, the future viability of many of the regions’ exchanges will be questionable. Distressed capital markets will undermine confidence in the regions’ financial system and hinder growth of the financial sector overall.

### **Compatibility and Compliance Challenges**

- The development challenge is compounded by individual markets’ varying levels of non-compliance with generally accepted international standards that result in operational anomalies between individual markets. In spite of marked progress in regulatory reform, Caribbean securities markets are not fully compliant with international standards. Not all regulators are experienced in monitoring sophisticated markets and there are anomalies between markets. Markets in the region do not support settlement guarantee funds. Such funds are a key element in the effective risk management of the settlement process.
- The Eastern Caribbean Central Securities Depository (ECCSD) uses Global CDS software for clearing and settlement. This is a small boutique system that is not fully compatible with international standards. The ECCSD faces the challenge of either upgrading this system or acquiring a new one, in addition to developing operational integration with the other depositories in the region.

### **Weakness in Investor Protection**

- The majority of countries do not have adequate investor protection schemes in place to meet international standards.

### **Varied transparency and disclosure standards**

- Compliance with international standards of reporting and disclosure varies. The OECS has the weakest reporting standards. There is a clear need to expand the IDB-ICAC program to the OECS to address: accounting and chart of accounts reform, standards training and dissemination and a legal framework for reporting.

### **Individual Country Weaknesses**

Several securities markets in the Caribbean have unique country-specific impediments requiring individualized remedial recommendations.

- The BCSDI is not compliant with generally accepted international standards. Immobilization of physical securities certificates is underway but has not been completed. As a result the settlement of securities transactions still requires the movement and exchange of physical security certificates. The persistence of physical security certificates in the marketplace requires that the Barbados capital market adhere to a Trade Date plus 5 days (T+5) Settlement Cycle. The Barbados T+5 Settlement Cycle is not compliant with the international capital markets standard of T+3 and is also not compliant with the T+3 Settlement Cycle operational in Jamaica, the Eastern Caribbean and Trinidad & Tobago.
- The sustainability and growth of the Jamaican capital market are impacted by circumstances that are unique to Jamaica. There are considerable macroeconomic issues existent in Jamaica that will not be resolved in the near future. As a result it is reasonable to assume that the GoJ will continue to issue debt bearing ever increasing, investor-attractive interest rates. The continuance of GoJ debt issuance will only intensify the current “crowding-out” effect.
- The majority of securities transactions in Jamaica are GoJ Repurchase Agreements, or Repos. Repos are transactions in which a market participant acquires immediately available funds by selling securities and simultaneously agreeing to repurchase the same or similar securities after a specified time at a given price, which typically includes interest at an agreed-upon rate.
- In most capital markets, Repos are usually contracted overnight or for a very short term of one to three days. In the Jamaican marketplace, Repo agreements are contracted for extended terms, which in some cases, can exceed 200 days. The extended term of Jamaican Repos, the large size of the transactions and the relative volatility of prices in the Government Bond market combine to create a potentially dangerous situation. In order to mitigate the risk involved in extended term Repos, international Risk Management standards recommend the use of Mark-to-Market valuation. The use of Mark-to-Market valuation assures that, for the term of the Repo, the market value the Repo’s securities is always equal to or more than the funds supplied.
- A long-standing problem in the Jamaican capital market is the existence of two sets of legislative acts governing Mutual Funds and Investment Trusts. The regulatory ambiguity regarding Mutual Funds has discouraged the formation of domestic Mutual Funds that would significantly increase the number of investment products available and mitigate the “crowding-out” impact of GoJ debt securities by offering investors a competitive level of asset safety.

## Conclusion and Recommendations for Capital Markets

Substantial assistance is needed in the area of capital market development. The governments of the Focus Countries fully recognize that the key to addressing size-related inefficiency challenges lies in greater intra-regional financial activity. However, in spite of various efforts to achieve integration, there is no obvious change agent to propel a regional securities exchange forward. Politicians typically view securities exchanges as a symbol of sovereignty; therefore official government support has been difficult to achieve. The exchanges themselves have too many vested interests to take effective ownership of this project, partly because each exchange has a natural preference to host a regional exchange.<sup>70</sup> Further, there are anomalies between individual markets in both the level of compliance with international standards, and operating and governance compatibility that hinder integration.

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<sup>70</sup> As was noted, a pilot project to increase regional securities exchange cooperation has been initiated by the local exchanges. This is a small-scale preliminary project, however, that cannot achieve the scope required for full-scale integration. It seems possible that the small scope may also reflect the ambivalence of the exchanges toward such integration.

The recommendations for capital markets focus on two areas. One set of recommendations concern the regional integration of the securities markets, to enable them to achieve the size and economies of scale necessary to play a significant role in financing the regions larger companies. These recommendations address regulatory compliance and harmonization, front-end technical issues and operational issues to make integration possible, and they address how integration may best be achieved with USAID assistance. The other set of recommendations address critical steps for strengthening the environment and the infrastructure for market deepening, increasing investment, and risk diversification.

### **Technical Assistance and Advocacy for the Harmonization and Subsequent Integration of the Regional Securities Exchanges**

It has long been recognized that one way to increase financial intermediation and improve access to new capital is to achieve greater integration among the region's securities exchanges. Combined ease of access to all of the markets would support greater investment, improve economies of scale, and make listings more attractive to issuers. This, in turn, would create a virtuous cycle of increasing numbers of issuers and investors<sup>71</sup>.

Drawing from its strengths in exchange development and its comparative advantages in being able to fund sustainable assistance, USAID should play an instrumental role in helping to facilitate the harmonization, regionalization and eventual integration of exchanges throughout the region. We would recommend USAID approach this strategic intervention through two sequential platforms of assistance. The first platform should be focused on making each of the participating exchanges compatible on an operating and system basis, and in achieving greater consistency with internal standards. Any form of greater regional integration would require full compatibility of the existing securities exchanges in terms of trading systems, settlement and clearance systems, and general compliance with international best practice. The second platform would be support for the integration of markets.

### **Support for the Four Existing Exchanges to Harmonize their Activities and Achieve Uniform Compliance with International Standards<sup>72</sup>**

In order to provide sustainable and transparent evidence that a consistent level of reasonable compliance exists between individual markets, a standardized Statement of Compliance is required. This certification is to demonstrate that market governance, trading operations, business by-laws, settlement conventions as well as regulatory oversight and compliance are benchmarked against international compliance standards. International investors will require clear and unambiguous evidence that each component of the regional securities exchange meets generally accepted international standards as recommended by: the International Organization of Securities Commissions (IOSCO); the Committee on Payment and Settlement Systems (CPSS) of the Group of Ten (G-10) Central Banks; the World Federation of Exchanges (WFE).

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<sup>71</sup> One indication of the advantage of stock exchange integration is provided by Capital and Credit Merchant Bank Limited of Jamaica, whose share price appreciated by 27 percent in the two weeks between the time it announced its intention to list on the Trinidad and Tobago Stock Exchange and the actual listing; had there been a new share offering, the broader market's willingness to pay more for the bank's shares would have directly benefited the bank (CMMB Securities Limited, "CMMB Stock Market Quarterly #4," November 2003). Another example is provided by the integration of the Baltic stock exchanges, where market capitalization increased from slightly over USD 2 billion in 1999 to approximately USD 6.3 billion in 2000, the year that the exchanges were integrated, and had grown to approximately USD 10 billion as of year end 2002. It is also relevant to note that two of the exchanges in the peer group – Cyprus and Malta – are actively constructing a regional exchange.

<sup>72</sup> Detailed recommendations, including recommendations specific to the individual exchanges, are discussed in Annex B.

Steps required to achieve harmonization of individual exchanges, including compliance with international standards:

- Harmonize trading platforms
- Harmonize clearing and settlement software and procedures, including settlement cycles
- Establish settlement guarantee funds
- Establish contingency funds<sup>73</sup>
- Establish compensation funds<sup>74</sup>
- Develop the ability of each country's Central Securities Depositories (CSDs) to clear and settle in multi-currencies
- Develop securities borrowing and lending program
- Technical assistance to country securities commissions, many of which are facing new regulatory responsibilities

In order to address some of the liquidity-related barriers to development, USAID should include in its package of assistance the development and implementation of a well regulated Securities Borrowing and Lending Program. Implementation of such a program will break the liquidity “logjam” by permitting market intermediaries to borrow securities from held positions to trade in the marketplace. It would focus on helping market regulators to establish basic requirements for the borrowing and lending of securities with borrowing and lending transactions being monitored by a market's CSD.

To implement this program, USAID would need to leverage private sector interest in integration. We believe this is strong, but that lack of a central and neutral organizing body has hindered progress. USAID would need to establish agreement among the securities exchange, Ministry of Finance, central bank, broker/dealer groups, and key financial intermediaries of each country (“the stakeholders”) on an action plan for harmonization. The plan should include the following:

- Detailed operational, regulatory, and business practice diagnostic of each exchange;
- Development of a road-map for harmonization outlining key steps and requirements;
- Consultation and consensus building among the key stakeholders. This would include the organization of a Harmonization Working Group; supported, but not led by USAID. This group would take ownership of the detailed implementation of the action plan, make key strategic decisions, resolve differences, and monitor the progress of each country;
- A needs analysis for each country, in respect of technical capability, donor support, and political support;
- Development of a detailed technical and legal plan for each country: including specifications and time-frames for completion; and
- Formation of linkages with international organizations and exchanges and major institutional investors.

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<sup>73</sup> Such a fund currently exists only in Trinidad and Tobago.

<sup>74</sup> Such a fund currently exists only in Jamaica.

A fully staffed program would require a full time project leader for one to two years; this person would be responsible for coordinating achievement of the necessary political consensus and the steps required to achieve harmonization. The project leader would also be responsible for coordinating the activities of four advisers, each of whom would be assigned to one country exchange to work on the issues outlined above. The work of each of the advisers is also a one to two year assignment, although not necessarily on a full-time basis. In some cases the country advisers will not provide assistance themselves (e.g. technical support on regulatory issues), but will arrange such assistance.

#### **Support for the Development of an Electronic, Integrated, Regional Securities Exchange with Remote Access for Intermediaries**

Once improved harmonization and compliance has been achieved, USAID should provide strong support for the development of an integrated market. The virtual exchange would be fully electronic, with remote access for all intermediaries; there would be no physical location, other than for the hardware. The existing exchanges would continue to operate, although it is reasonable to assume that they may disappear over time, or evolve into regulatory bodies, as more activity is taken over by the regional exchange.

An integrated market would list selected issues from each individual market on a separate electronic trading board to which approved intermediaries would have remote access. Implementation of an integrated regional securities market requires a considerable amount work on the part of regional exchanges, Central Banks and Market Regulators to establish the requisite levels of operational and regulatory reciprocity. Some of the key implementation requirements are contained in the body of this report. The integration of listings on a regional securities exchange with cross-border trading would leverage the collective availability of the region's stronger issues.

Steps specific to new regional exchange:

- Determine necessary hardware and software for integrated exchange

#### **Options for Integrating Exchange Markets**

There are three ways to achieve regional stock exchange integration: 1) cross-list the major issues of each exchange on all of the other exchanges; 2) create a completely new exchange; 3) create a "virtual" regional exchange.

The *cross-listing approach* is technically and politically the simplest. Several companies have already cross-listed and the process is straightforward. Cross listing is also the simplest solution politically because each country would be able to maintain its own separate exchange. Maximizing the efficiency of cross listing would require that all of the exchanges have compatible cross-trading platforms and settlement and clearing systems. The cross-listing approach has three major shortcomings. First, while technically simple, it is inefficient for the listed companies, who will have to comply with the regulations of the exchanges in all four countries. Second, this approach requires that all of the companies agree to cross-list; if they do not, there is a risk of considerable confusion if some companies decide to cross-list on some exchanges and not on others. Third, if most companies do cross-list, it seems inevitable that one of the exchanges will eventually become dominant. While domestic investors will favor their own exchange, foreign investors will presumably gravitate to whichever exchange offers the best services. Therefore it is not clear that the cross-listing option actually will protect the local exchanges in the long term.

The second option - creating a *completely new exchange* - is both the most expensive and the most difficult politically. Just one example of the political considerations is that the OECS has just recently completed the creation of its own securities exchange; it is inconceivable that it would be willing to abandon this project in favor of a new regional exchange. A related option, which would be less expensive, would be for one of the existing exchanges to be converted into the regional exchange. Political considerations make this an unrealistic option.

The third and final option is to create a *"virtual" integrated regional exchange* that would list issues from individual exchanges but that would be fully electronic, with no physical location other than for the hardware. This option would essentially achieve the same result as the cross-listings option, except that the issues would all be cross-listed on the same virtual exchange. It would also enable the existing exchanges to continue to operate, although, as with the cross-listing option, it would be reasonable to expect some of the domestic exchanges to diminish in importance over time.

- Reach agreement on creation of a regional regulatory body
- Establish a membership structure that permits participation by a broad range of intermediaries

Finally, as noted, the regions' exchanges need both to enhance their individual operating profiles and provide incentives for new intermediaries to enter. In order to increase the number and type of investment instruments available in the markets, activities may include: a) the design and implementation of corporate education and incentive programs to encourage regional corporations to meet their long-term capital needs by the issuance of a variety of fixed income instruments; or b) technical assistance to support listing of the region's Government and Government Agency debt issues be listed and traded on an electronic, integrated, regional securities exchange. In order to increase the number of market intermediaries, support could be provided to the regional securities exchange and regional regulators to: a) establish a commission scheme and participation incentives that are attractive to exchange members; or b) establish an exchange membership structure that permits participation by Caribbean-registered but foreign-owned trading firms.

The clear advantage of a virtual regional securities exchange is its ability to achieve economies of scale. By having more listings than any of the individual exchanges, the regional exchange would be able to attract more intermediaries, result in more investment and trading, and facilitate more securities issuance. (The size of the Pan-Caribbean market in Annex B, Table 3 does not assume any of this additional growth.) It is particularly relevant to note that the integration of the three Baltic securities exchanges led to an increase in total market capitalization of slightly over USD 2 billion in 1998 to over USD 10 billion in 2002. The detailed recommendations in Appendix B also include other means of maximizing the success of the exchange, such as keeping it open for 12 – and possibly 24 – hours, as well as developing participation incentives for intermediaries.

#### **Technical Assistance for the Development and Harmonization of Investor Protection Measures**

Efforts to strengthen protection of investors should be centered primarily on three areas: 1) more stringent setting and enforcement of disclosure requirements of publicly traded securities; 2) tougher regulation of the market conduct, promises, and undertakings of financial intermediaries; and 3) statutory requirements for the creation of investor protection schemes.

USAID can play a very specific role in helping countries design and implement investor protection funds, independent of efforts around integration. While the lack of formal protection measures is just one of a number of issues that erodes market confidence (disclosure and liquidity are two others), they are an integral part of the resiliency of a market. Given the extent of the vulnerability of countries in the region, USAID's support in this area would help to address an important weakness that stands in the way of market development, particularly in the retail sphere. Where achievement of USAID's strategic objectives will lead to more employment and higher income for the population, the market will have greater need for domestic savings to be intermediated through the capital markets. Protection of small investors is key to savings mobilization.

USAID assistance should be directed at the securities exchanges, clearing and settlement intermediaries, depositories, and registrars.

#### **Strengthening of Information Disclosure and Financial Reporting**

USAID can play an important role in extending accounting reform to the OECS. Such an initiative would also dovetail with the ECCB's plans to create a regional accounting institute. Effort should focus on: adoption of international accounting and auditing standards; support for the development of laws and

regulations for better disclosure; support for building legal frameworks and institutions to comply with governance standards. Work should include:

- Review the current financial reporting standards that are being used in the region, measured against the International Financial Reporting Standards (IFRS), formerly International Accounting Standards (IAS);
- Develop a strategy to strengthen financial reporting by enterprises and corporations that will comply with IFRS, as well as adoption of International Standards on Auditing (ISA) for auditing requirements;
- Recommend a training curriculum to strengthen the existing accountants and auditors professional development in line with IFAC;
- Provide guidance on strengthening the ethics and independence of accounting and auditing profession; and
- Conduct a review and analysis of the necessary legislative changes required to promote effective monitoring and enforcement of professional implementation of IFRS and the highest standards of ethical behavior and implementation of ISA.

USAID has a comparative advantage in this type of reform through the existence of the Global Development Alliance, which has been used to leverage public private partnerships involving international accounting institutes and local accounting firms to strengthen accounting standards and develop certification regimes. USAID may want to consider the use of the GDA in this context. Further, given the proximity of the OECS to the US and the availability of public institutions, NGOs and universities that train in accounting standards, USAID should seek to develop a series of study tours or seek the assistance of US-based institutions in the region to help build capacity, train, and form professional associations with local counterparts.

#### **Targeted Support for the Development of Corporate Debt Markets**

While broad-based support for financial market deepening may not be effective without first achieving the standards for compliance and harmonization that are noted above, there are at least two near-term needs that USAID could address that would support both enhanced capacity for financial intermediation and eventual growth of non-bank, corporate debt.

#### **Provide Technical Assistance to the Regional Depositories to Assess the Operational and Financial Practicality of Enhancing Settlement Systems, or Replacing Settlement Systems to Accommodate Fixed Income Transactions**

The inability of the regions' major exchanges to settle fixed income transactions in a reliable and timely way represents a major barrier to the development of secondary debt markets. Technical assistance is required to assess the Equator system's suitability for fixed income settlement in the Caribbean region, the financial practicality of implementing enhancements to the system or the procurement of a suitable replacement settlement system. One or two short-term advisors to each of the major exchanges could provide assistance. The leading banks with merchant banking arms would be supporters of this initiative.

#### **Support for the Successful Development and Launch of a Regional Rating Agency**

The potential contribution of a regional rating agency to growth and diversity in capital raising cannot be overstated. Stakeholders have recognized this, and a substantial amount of work has already been done on the development of a business plan, and a plan to attain participation of institutions throughout the region. However, notwithstanding the challenges in turning the business plan into a viable venture, the success of

any nascent rating agency will depend on a two factors, both of which USAID can address through its support<sup>75</sup>. The first factor is independence; the second is credibility.

At the time of writing this report, development efforts for the regional rating agency were progressing well, although capital and full buy-in from stakeholders in the region was not complete. There are questions of scale and whether the proposed agency can in fact adopt a regional-specific approach to ratings.

We recommend two potential roles for USAID depending on how success is achieved by the private sector. The first role would involve USAID providing complimentary support to the rating agency in helping to build market acceptance and market outreach. The second role for USAID would come to play if the private sector initiative currently underway does not succeed, and that is to take a founders role in the establishment of a rating agency.

*Support to a new private agency:* In this role USAID would seek to form a public-private partnership with the rating agency for a broad program of advocacy, information dissemination, and outreach and demonstration projects. USAID would provide advisory support to help the rating agency develop a regional-rating methodology and build its reputation throughout the region through an outreach campaign and one or two pilot projects that would be co-funded by USAID and the rating agency for the benefit of middle market enterprises seeking finance. This adviser, who would be prominently positioned as a USAID adviser, would therefore be responsible for assisting the agency in plotting its target client strategy, and, assuming that the initial rating results are successful, in working with the agency to propagate the results effectively. By working closely with the agency, the adviser will also be positioned to determine whether other time-sensitive keys to success emerge in which USAID could play a role. IDB's apparent willingness to subsidize the cost of smaller issuers is an example of a useful donor role that USAID could replicate or compliment; other as yet unforeseen needs for other assistance may well emerge as the project proceeds.

*Establishment of a USAID-funded agency:* This role would be significantly more challenging in so far as USAID would need to lend more support to the effort with greater risks. There are models for this form of initiative. USAID might establish a foundation, or an institute that would be staffed with international advisors specialized in debt rating methodologies and local professionals. The entity would be developed into a full fledge rating operation, providing subsidized rating services and market access support to qualified enterprises. The aim would be to develop a sustainable operation, establish a track record of successful service, introduce ratings to the local markets, and eventually exit by either selling or transferring the operation – as a viable business - to an independent private party. We have seen this “incubator” approach prove successful in Kosovo where USAID established a full-service retail bank and then sold it to a private regional bank in two years. In Russia, a commercially oriented corporate finance rating operation was built on the back of a corporate governance institute.

This approach will likely require a two to three year program involving three to four international advisors. There would be a local staff of trainees who would be developed to eventually run the rating operation as part of an exit package. The agency could work with local exchanges and corporate finance houses to develop pipelines of potential borrowers, some of whom with the support of a rating would potentially list on the exchange.

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<sup>75</sup> Note that USAID has facilitated the development of other rating agencies, such as CERA in Poland.

Regardless of how it is established, the importance of the successful launch of the regional rating agency cannot be overstated; an integrated regional securities market will not be successful if it does not result in more listings.<sup>76</sup>

USAID support would have a significant impact on further growth of the region's capital markets. By enabling more companies to raise debt in the capital markets, the agency will create more competition for bank debt, thereby lowering the overall cost of borrowing and contributing to the increased profitability of the corporate sector. An increase in the sources of debt finance could also lead to increased innovation in the variety of debt products, as banks and investment banks respond to the increased competition. The rating agency will initially focus on debt issues, but increased debt market activity could be expected to eventually lead to increased equity market activity as well, as issuers, investors and underwriters, respond to the opportunities created by more active local markets.

The rating agency will also play an important role in raising the overall level of understanding of capital markets in the region by means of its research publications, seminars and general marketing activity. The rating agency's success depends on two factors. One is that the market is viewed as credible, independent and genuinely regional – not just an export from Trinidad and Tobago. The second is that its first ratings actually do enable the rated companies to raise debt less expensively than from the banks.

Although an argument could be made that the rating agency will hurt the banks by taking away their best clients, many of the large banks also have investment banking businesses and therefore can shift earnings from lending to fee generating activities. Furthermore, the benefits of increased vitality in the corporate sector, resulting from increased financing options, will have positive spin-off effects on the economy overall, including the banks.

#### **Targeted Technical Assistance to Jamaica for the Strengthening of its Market Infrastructure and Supporting Organizations.**

Jamaica is a strategically important country for USAID assistance, it is an economic force in the region, and it has a tenuous financial position that could threaten stability if market diversity is not achieved and structural reforms are not put into place. During the course of our review of the Jamaican capital market, a number of critical needs were identified for which USAID could lend support through both long and short-term interventions. These include:

- *Development and integration assistance to the Jamaican Stock Exchange Specialty Market:* In order to increase the viability and revenues of the JSE, it is recommended that technical assistance be provided to the JSE to develop a comprehensive Business Development Plan including the creation of JSE specialty markets and integration with Central American markets.
- *Business development assistance to the Jamaican Central Securities Depository:* In order to provide a reasonable level of sustainability and growth for the JCSD, it is recommended that technical assistance be provided to create a practical business development plan for revenue growth and sustainability. The JCSD plan should address: the development of a role in acting as registrar for government debt issues, bondholder register services for those issues, and implementation of a mark-to-market valuation service to marketplace participants.
- *Legislative support for the development of mutual funds:* In order to attract Mutual Fund registrations and the trading of Closed-End Mutual Funds, it is recommended that technical assistance be provided

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<sup>76</sup> Although beyond the scope of this assessment, a useful topic for further review would be whether fiscal policy plays any role in discouraging use of the capital markets and/or whether fiscal incentives could provide a jumpstart for increased use.

to the Jamaica FSC to resolve conflicting legislative acts regulating mutual funds and collective investment schemes.

## Summary and Prioritization of Key Recommendations for Capital Markets

Strategy/ Recommendations	Priority Sequencing	Potential Strategic Impact	Affected Market Segment(s)	Technical Requirements	Political Will/ Change Agent	Risks
<b>CAPITAL MARKETS</b>						
<b>Support for harmonization and integration of regional securities exchanges</b>  <i>Part I: Support for harmonization of operations and regulations</i>  <i>Part II: Support for implementation of a virtual securities exchange</i>	High – Part I immediately implementable; Part II will have no feasibility without Part I achieved.	Harmonization of standards and regulations will set the stage for integration. This first step will improve the credibility and attractiveness of the markets to investors. Some form of integration and cooperation is a key requirement to both ensure the viability of the regions exchanges and create a virtuous cycle of new sources of capital and savings. The creation of a virtual regional exchange is deemed most politically acceptable.	Large and medium-sized enterprises.  Market intermediaries.  An increase in sources of capital will increase competitive pressure on banks.	Regulatory specialists.  Exchange operations and management specialists.  Strong project management and consensus building skills.	Strong, but un-aligned among target countries /securities exchanges, market intermediaries and regulators.	<ul style="list-style-type: none"> <li>Harmonization efforts will drag on. Political issues will prevail to undermine the spirit of cooperation.</li> <li>Stakeholders will give up</li> </ul>
<b>Support for the development of investor protection schemes</b>	High – immediately implementable.	Well-designed deposit protection in OECS will facilitate savings mobilization, lead to closer harmonization with other countries in region, and strengthen market discipline.	Small investors throughout the region.	International knowledge of deposit protection schemes.  Insolvency expertise.	Strong /JSE, JCSD, market intermediaries.	<ul style="list-style-type: none"> <li>Stakeholders may lose will for reform if protections require changes to law, or threaten politically vested groups.</li> </ul>

Strategy/ Recommendations	Priority Sequencing	Potential Strategic Impact	Affected Market Segment(s)	Technical Requirements	Political Will/ Change Agent	Risks
<b>Support for accounting reform and disclosure in OECS</b>	High – immediately implementable.	The integration of securities markets in the region and the success of the newly formed East Caribbean market rest in part on adequate disclosure and reporting. Improvements in transparency and disclosure are key fundamental first steps for improving financial intermediation and capital access.	All investors – small and large.	Linkages with ICAC and US-based accounting organizations.  Accounting and auditing trainers.	Unclear /ICAC, local accounting professionals, IFAC.	<ul style="list-style-type: none"> <li>Widespread adoption of international accounting standards.</li> <li>Improved laws on disclosure.</li> <li>Improved legal frameworks promoting compliance with OECD principles of disclosure and governance.</li> </ul>
<b>Support for the development of non-bank debt markets</b>	High – Implementation dependent on success in harmonization and compliance efforts.	An improved infrastructure for fixed income transaction origination and settlement would support growth of primary and secondary markets for non-bank debt. Growth in this market would boost financial intermediation by bringing new users and sources of capital together with an intended effect of lowering the cost of debt.	Large and medium-sized enterprises through lower costs of debt; banks will experience more competition for credit. Governments may face reduced demand for their debt. New and strengthened markets for fixed income products will benefit exchanges and market intermediaries.	High but dependent – immediately implementable, but would condition support for a rating agency on the successful outcome of recent efforts by the private sector to set one up.	Strong /JSE, JCSD, market intermediaries	<ul style="list-style-type: none"> <li>Improvements to exchange systems that allow accurate and reliable settlement of fixed income transactions.</li> <li>The creation of a credible and independent regional rating agency.</li> <li>Lower borrowing costs.</li> <li>Growth in public listings of corporate bonds.</li> </ul>

Strategy/ Recommendations	Priority Sequencing	Potential Strategic Impact	Affected Market Segment(s)	Technical Requirements	Political Will/ Change Agent	Risks
<b>Support to strengthen Jamaican securities markets</b>	Constructive – immediately implementable	Strengthening of the JSE and its related institutions will help to create a robust market environment. The impact of recommendations on financial intermediation is indirect, but is significant in its supporting role for growth.	Jamaican capital market intermediaries and investors.	<p>Stock exchange business management expertise.</p> <p>Registrar operations and management.</p> <p>Valuation expertise.</p> <p>Repurchase agreement specialization.</p>	Strong/JSE, JSCD, mutual fund industry	<ul style="list-style-type: none"> <li>• An improved business profile for the JSE.</li> <li>• An improved business profile for JSCD.</li> <li>• Increased capacity of JSCD to provide bondholder registrar services and mark-to- market valuation services to the marketplace.</li> <li>• An improved environment for mutual funds and growth in the number of mutual fund registrations.</li> </ul>

# TRANSMISSION OF REMITTANCES

## Background

The increasing focus on remittance flows in recent years has resulted from several factors. There has been growing recognition of the importance of remittance flows to nations' balance of payments, households' income and safety nets, and the economic benefits that can result from remittance flows when investment levels, trade, and other sources of financing are not as widely available as desired. For the recipient countries, these can be of immense importance, sometimes exceeding 10 percent of GDP. The OECS countries are both recipients and senders of workers' remittances and other private transfers, with consolidated outflows approximately 32 percent of inflows.

The remittance figures for the OECS<sup>77</sup> (approximately \$211 per capita and 4 percent of GDP) are higher on a per capita basis than in many Central and South American countries, although they represent a lower proportion of GDP. This relatively high volume of remittances poses two potential opportunities for economic development. One is to concentrate the flows, so that: (1) the intermediary can lower costs because of greater economies of scale and (2) if the flows are sufficiently large and predictable, the intermediary can rely on them as a source of liquidity or even an element of core deposits.<sup>78</sup> The other opportunity is to reduce costs in other ways, such as by improving the technology. A third and related opportunity, which requires some form of public sector intervention, is to build on remittance flows for longer-term investment.

This section examines:

1. The make-up, sources and uses, and intermediation of remittance flows in the OECS and their economic impact;
2. Gaps and vulnerabilities in the current environment; and
3. Recommendations for improving remittance flows and potential USAID interventions

A more detailed assessment of remittances in the OECS is provided in Annex C.

## Economic Impact of Remittance Inflows in the Eastern Caribbean

As elsewhere around the globe, the economic impact of remittances is perceived to be important in the Eastern Caribbean, albeit less important than in other regions. Remittance inflows have been about US\$110-125 million a year for the OECS region, accounting for about 4 percent of GDP. This is less than other parts of the Latin America-Caribbean (LAC) region, as well as other parts of the globe. For instance, the IDB claims there are six countries in the LAC region where remittances exceed 10 percent of GDP,<sup>79</sup> with Central America being particularly prominent. While the Eastern Caribbean figure is lower than some other parts of LAC, it is in keeping with some neighboring Caribbean countries. For example,

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<sup>77</sup> The remittance analysis in this assessment concerns the OECS countries.

<sup>78</sup> Even if the intermediary is a money transfer agent such as Western Union, the agent will place surplus funds in a bank.

<sup>79</sup> See <http://www.iadb.org/>. Separate calculations using IMF data point to El Salvador, Ecuador, Haiti, Honduras, Jamaica and Nicaragua as the countries with the highest remittance inflows when compared to GDP. (See IMF, *International Financial Statistics* for 2001 GDP converted to US\$ at annual average rates; and workers' remittances in the *Balance of Payments Statistics Yearbook*, 2002). The IDB cites the Dominican Republic as well based on earlier figures. Increasing dependence on remittances may be a more recent development in Honduras.

in Barbados, the figure in 2001 was \$100 million in remittance inflows, or 4 percent of GDP.<sup>80</sup> While OECS ratios are lower than in other parts of LAC, the 4 percent share in the OECS countries is higher than about two thirds of the other LAC countries. Irrespective of the comparative regional measures, they are important by themselves, particularly given the openness of their economies, the fragility of the tax base, the small size of each of the countries, the reliance on tourism receipts for foreign exchange, and above all, the vulnerability of the region's small economies to external events and natural disasters.

Remittance inflows are equivalent to about 13 percent of gross tourism receipts, and more than 41 percent of merchandise exports. Likewise, they are equivalent to about 37 percent of inward direct investment, a level that has been higher proportionally since 2001. They also exceed Government transfers and ODA received, thus helping to provide an income supplement and a safety net as Government support shows declines. The summary table below presents key figures for the region to assess economic magnitude.

There are remittance *outflows*, some of which are intra-OECS, and others which flow from OECS members to non-member states. Based on ECCB data, private transfers out<sup>81</sup> of the OECS countries approximated \$43.8 million-equivalent per year from 1998-2002, or about 32 percent of total private transfers into the OECS member states. This is reported to include sizeable flows to Guyana and the Dominican Republic, depending on the member state, although specific tracking of outflows was not done for this study.

### Sources of Remittance Flows

There is only fragmented information on sources of remittance flows from overseas communities of OECS nationals. The conventional view is that most of the overseas OECS population is in the United States, Canada and the United Kingdom, with smaller pockets in other parts of the Caribbean and Europe. A significant migration to the UK occurred in the 1950s and 1960s, whereas the flow to North America increased in the 1970s. Today, more OECS nationals are thought to be on the eastern seaboard of the U.S. than in the UK or Canada. However, there are also UK citizens who are the children of OECS nationals, some of whom visit fairly frequently. Thus, if those numbers were included, they might shift the balance. There is also a view that those who left for the UK 40-50 years ago have long had plans to return and retire in the Caribbean, and that this is a major source of investment in property development. By contrast, anecdotally, OECS nationals in North America are generally not projected to return when ready to retire. Part of the contrast is the view that there were greater barriers to citizenship and acceptance in the UK in the 1950s-60s, whereas these barriers have come down since. One can argue the same barriers existed in North America, and that this was a deterrent to out-migration to the US and Canada at the time. However, the current impression is that OECS nationals are now more welcomed in all three locations, and more likely to settle as a result. The reason for greater numbers leaving primarily for the United States is the sense that there are greater economic and educational opportunities.

There are only estimates of how many OECS nationals live abroad, and this is a moving figure. Some have become citizens of other countries, yet they retain ties to their OECS countries. Many people are abroad on a short-term basis (a few months, or a few years for study and training). However, taking these and other factors into account, rough estimates are that the OECS community abroad approximates 200,000. This would be about 35 percent<sup>82</sup> of the approximate population in the OECS countries as of

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<sup>80</sup> Figures are from the Central Bank of Barbados and the IMF.

<sup>81</sup> EC\$591.9 total, converted at EC\$2.7 per US\$1. Figures are debits to "other sectors" under Current Transfers of the balance of payments. No effort was made to differentiate worker remittance outflows from any insurance or pension payments, or any other non-remittance transfers.

<sup>82</sup> This is consistent with the English-speaking Caribbean. See M. Orozco, "The Impact of Migration in the Caribbean and Central American Region", FOCAL, 2003.

2000-01. The figure, if accurate, primarily applies to the US, Canada and UK. The number would likely be higher when accounting for intra-OECS and intra-Caribbean migration. For instance, anecdotal estimates show that Antigua's population of about 70,000 is less than two-thirds Antiguan. Likewise, in many OECS member states, there were anecdotal reports that the population abroad equals or exceeds the population at home. Thus, the numbers abroad may not be 570,000, but they may be greater than 200,000.

### **The Role of Overseas Organizations and Uses of Remittances**

Among the OECS communities abroad, there are scattered reports of organizations that have links back to the home country. Generally, OECS embassies and high commissions serve as the focal point for communities abroad to organize themselves.

Loose organizations sometimes mobilize resources and donate funds to charities and other causes. For instance, organizations from the eastern seaboard of the US (mainly New York, Washington D.C., and Atlanta) have reportedly donated funds to orphanages, homes for the elderly, health clinics, and other humanitarian causes. However, information on the amounts of these donations is not available, and there is nothing systematic or widespread.

There has not been any reported "hometown association" scheme of the sort that the Mexican or Salvadoran communities have organized out of the United States that leads to investment in roads, other infrastructure, housing, etc.<sup>83</sup> Nor has there been any known initiative to encourage closer ties on an organized basis, as has been reported anecdotally about the Jamaican community in New York and Toronto. In some cases, associations abroad are linked to the ruling party of government, or to opposition parties. This may make it easier for parties to fly non-residents back home (if eligible to vote) in exchange for votes. However, this simply perpetuates patronage, rather than stimulating investment. This also undercuts the willingness of many OECS nationals abroad to link any remittance flows to government-organized efforts that promote economic development. Again, when funds have been sent back in organized ways, they tend to support social infrastructure (e.g., health, education) in focused areas. What has been sent back is modest compared to the kinds of development projects being undertaken in parts of Mexico.

As for financial institutions with outreach programs, there is little to report. Scotiabank in Grenada has reported some success with marketing efforts in New York, Toronto and London. Some other banks have begun initial research, and one or two have gone to the UK and North America to gather information. A credit union in Nevis is reported to have initiated an outreach program. This was focused on Nevis citizens in St. Croix, St. Thomas, St. Maarten, Philadelphia and New York, with apparent results when measured by new accounts. Such efforts, if replicated by other credit unions, could help to strengthen the links with overseas communities, and with it the flow of remittances back to OECS markets. However, overall, OECS nationals abroad tend to transfer funds to family and others on a more private and

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<sup>83</sup> For instance, hometown associations among Salvadoran migrants in the US have formed committees that have direct cross-border links with the objective of rebuilding home communities. Programs in Oaxaca and Jalisco in Mexico have led to public works projects being carried out by hometown associations with co-financing (usually matching) from state or municipal governments (as well as loans in some cases). Other examples have included associations in the US coming together to finance or co-finance completion of sewage systems, or to purchase/donate a school bus, wheelchairs, walkers for the elderly, and a health clinic. In the case of the Jalisco Hometown Association, they are currently engaged in a pilot project with UCLA to channel remittances from the US for productive investment in Jalisco state (where Guadalajara, Mexico's second largest city, is located). This pilot involves investment from the association, match funding from the Jalisco state government, technical assistance for effective implementation of projects, and transparency. See R. Moore Ortiz, "Mobilizing Remittances from Jalisco Hometown Associations to Productive Investment Projects", California in the World Economy, 2003.

individualized basis, rather than following any organized effort from governments or financial institutions.

The remittance inflows are generally used as income supplements for a range of needs—health care, clothing, food, child support, gambling/lotteries, etc. In some cases, they are used to purchase small inventories for commercial trade businesses. This is also a major portion of remittance outflows, essentially pre-payment for goods imported. For the most part, discussions throughout the region suggest that remittances are used to finance personal consumption and basic needs, not investment. The small average value of transactions through Western Union and Money Gram (see V-D below) reinforces this impression. Relative spikes in remittance inflows are basically during carnival season, the beginning of the school year (for fees, uniforms, books and supplies), and Christmas. As noted above, there are also significant in-kind remittances known as the “barrel trade”.

As far as the use of remittances (and other direct private transfers<sup>84</sup>) for investment purposes, they are used primarily for property development. In some cases, the funds may be used to start up a business, or to finance a relative’s/friend’s business. However, in most cases, people abroad remitting back large enough sums for a house are usually doing so after many years of work abroad. Or they have done so in installments, with transfers going directly into their own deposit accounts. At this point in their lives, they are more focused on a comfortable retirement than a new business enterprise. As such, the remittances may be for payment on tracts of land, permits/licenses needed for construction, and the actual construction of the house itself. These are often done on an installment basis, which explains some of the partial construction of housing in the region. Such an approach has reportedly been subject to abuse, leading to cost overruns (not atypical in construction) and/or dodging code requirements. Such problems serve as a deterrent to investment, particularly when building codes need to account for hurricanes, and when building materials are often expensive and imported.

Relative to other communities in the LAC region, there is nothing documented that would permit a comparison of OECS nationals abroad with their peers from the LAC region. Findings from a survey<sup>85</sup> and other studies<sup>86</sup> conducted by the IDB of migrant populations from Latin America and the Caribbean in the US have shown the following:

#### Common Sources and Uses of Remittances

- About 70 percent of migrants send money home
- Most send funds back home regularly (7-8 times a year)
- Almost 60 percent have lived in US for more than 10 years
- More than two-thirds of migrants are 25-49
- Most earn less than \$20,000 per year in the US; despite this, they are more likely to send remittances back home than those earning more than \$40,000 per year
- Most migrants send back at least \$3,000 per year; transfers are often about \$200-\$300, and sent 7-8 times a year
- Since September 11, remittances may have declined due to a slower US economy, and less earnings resulting from job losses; however, this is not entirely sure, as the amount of remittances from the US to LAC has increased substantially from 2001 to 2002
- The longer migrants are away, the less money (relatively or absolutely) they send back; this is partly because remittances are meant to cover the needs of parents and others who have passed on once migrants have been away for more than 10-20 years
- Convenience of remittance transmission is more important than cost; this is one of the reasons why more expensive money transfer companies will continue to have significant market share of the remittance transaction market

<sup>84</sup> This would include proceeds from pension payments and other retirement savings received from abroad.

<sup>85</sup> See “A Survey of Remittance Senders, U.S. to Latin America”, Bendixen and Associates (for the IDB).

<sup>86</sup> Manual Orozco of the Inter-American Dialogue project of the IDB has produced numerous studies on remittances, many of which have been used in this report.

It is not known whether OECS nationals abroad follow this profile. However, as noted above, the demographic information on the Caribbean community in the United States fits some of these characteristics. This includes more than 60 percent having been in the US for more than 10 years, 59 percent are between 21-55, and there is widespread use of money transfer companies like Western Union and Money Gram. In terms of the last point, most remittances also come in small lots of about \$200-\$300 per transaction, as they do from Latin American and other Caribbean immigrants.

However, there are also differences, namely that the Caribbean-born population is wealthier on average than its Latin American counterpart, and job losses may not have been as high after September 11. The Caribbean-born population is also not likely to be as “un-banked” as the Latin American population, partly due to OECS banking tradition, possibly due to language skills, and possibly because the Caribbean-born population has tended to locate in cities that lend themselves to greater organization (e.g., credit unions, churches) as opposed to many Mexicans and Central Americans who have worked in agriculture and on itinerant construction squads.

## **The Financial Sector and Remittance Transfers**

### **Banks**

The OECS countries have a high degree of banking penetration. Significant numbers of people/households have bank accounts. Fairly standard measures of financial intermediation (e.g., broad money to GDP) and banking penetration (e.g., banking assets to GDP) suggest the OECS members are more “banked” than their counterparts in Latin America. There is also much greater membership in credit unions than in Latin America as well.

Banks are responsible for clearing, and thus are the focal point of remittance flows through the formal financial system. Even those transfers going through the credit unions, money transfer companies and other institutions have to clear and settle through their accounts at the banks. Thus, the banks play a key role in the remittance market of the OECS.

In terms of specific market share, it is not possible to quantify with precision. As noted above, there are no forms that specify “remittance” as opposed to other transfers and transactions. However, because of the high percentage of people with accounts, transfers often go through the banks. In particular, for those with accounts (or accounts abroad with correspondent banks), transactions are generally cheaper than those sent by money transfer companies like Western Union. Exchange rate manipulation is the additional source of earnings for banks and money transfer companies on remittance transfers. However, this is less of an issue in the OECS than in other countries.

Problems associated with the banks, for many people sending/receiving remittances, include the perception of complex procedures, waiting time, lack of an account (among the poor and disenfranchised, who are among those most likely to receive remittances for support), and the general perception that banks are not necessarily fair or interested in people.<sup>87</sup> For those living in more rural and mountainous areas where bank branches are not easily accessible, this obviously adds a barrier. For these reasons, money transfer organizations like Western Union and, to a lesser extent, Money Gram, will continue to have a significant share of the market.

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<sup>87</sup> This is a report of perceptions. The study does not necessarily agree with any or all of these views.

## **Credit Unions**

Credit unions are relatively insignificant in the OECS states with regard to remittances. This is partly because remittance transactions (and other transfers) are cleared through banks, and because the money transfer companies are faster and more convenient. Credit unions generally lack the technology for fast transfers (as per the money transfer companies), and they still have to go through the banks even if members at home or abroad wish to remit funds (in either direction). Moreover, because credit unions generally do not have ATM networks, debit cards, credit cards, and other basics of electronic banking, their mix and range of services is more focused on traditional deposit safekeeping and small-scale lending. They are also restricted from engaging in foreign exchange-related activities in the various Cooperative Societies Acts, thus limiting the scope of their remittance activities to depositing EC\$ checks sent from abroad and following the payment instructions once communicated by the clearing bank. For all intents and purposes, credit unions are virtual non-players in the OECS remittance market.

There is clear potential to change this. According to the World Council of Credit Unions (WOCCU), the Caribbean region has about 350 credit unions with more than 1.4 million members. The penetration rate<sup>88</sup> is nearly 33 percent, making the Caribbean the largest credit union market outside of North America, where the penetration rate is 42 percent.<sup>89</sup> However, credit unions are small in size and scale in the Caribbean. Moreover, there appears to be a high concentration of one or two credit unions in each OECS member state, with many of the others being very small in assets, reserves, and general capacity to serve members with more than very basic services.

## **Money Transfer Companies**

Estimates from our research are that Western Union has approximately 20-30 percent of the OECS remittance inflow business based on value and a higher share based on number of transactions. Money Gram, whose agent in the OECS is often RBTT Bank, appears to have approximately 5-10 percent market share in countries in which data has been made available. These market share estimates do not differ significantly from those in other LAC markets; the IDB estimates that Western Union has an approximately 30 percent market share in many LAC countries, while Money Gram's share is approximately 11 percent.<sup>90</sup> While many remittance-receiving countries have significant informal sending channels, it is assumed that the remaining share of remittances in the OECS is largely sent through banks. The US Postal Service plays an insignificant role, with very small dollar amounts per transaction and the transactions themselves numbering in the low thousands for countries in which the information is available. This remittance method is considered slow and unreliable.<sup>91</sup> Credit unions also play an insignificant role. Finally, sending money by checks is not considered practical, because it can take up to two months for the checks to clear.

Money transfer companies typically charge a percentage fee in the range of 12.5 percent for the majority of transactions (percentages are on a sliding scale), compared to the fixed fees charged by banks, which, according to the banks interviewed for this project, are approximately USD 30-45 from the US and USD 20-30 from Canada. With average remittance amounts in the range of USD 200-300, a money transfer that costs 12.5 percent is the most expensive alternative for sending USD 300, at a cost of around USD 52.50, compared to the fixed fees. However, it is generally believed that for payments in this size range

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<sup>88</sup> Calculated as the number of members divided by the economically active population.

<sup>89</sup> In this regard, the penetration rate for the Caribbean states was higher than in Canada. Thus, apart from the United States, the Caribbean region has the highest penetration rate in the world.

<sup>90</sup> M. Orozco, "Remittances to Latin America and the Caribbean," IDB, 2002.

<sup>91</sup> Average postal service transfers in Antigua and Barbuda, Dominica and Montserrat are USD 70-85. The average in St. Kitts and Nevis from 1999-2001 was USD 25-35. In Anguilla, the average amount in 1999 was under USD 10. [www.upu.int](http://www.upu.int).

the senders tend to weigh the convenience – which also has a cost - of the money transfer companies more heavily than the fees.

While it can be tempting to say that the money transfer company fee structure is excessive, it should be borne in mind that banks are able to allocate their fixed costs over a wider range of services than can the money transfer companies. Also, the reporting costs associated with money transfers have risen significantly in recent years as part of global efforts to reduce money laundering. It is relevant to note that one Caribbean bank that had served as a very successful agent for Western Union was forced to drop the business when new anti-money laundering procedures made the business unprofitable.

Remittances raise two policy issues that are discussed in Part V of this report: (1) how to reduce the cost remittances so that more money is available to the recipient and (2) whether there are ways to leverage remittances as a source of investment, rather than for its current consumption-oriented applications.

### ***Other Institutions***

The role of other organizations in remittance inflows is not reported to be all that prominent. Travel agencies and courier services handle some of the traffic. This generally is cleared through (and captured statistically by) customs.

The postal system plays a very minor role in sending or receiving international money orders or other forms of remittances. It is considered slow and, in some cases, unreliable. With the recent involvement of the US Postal Service in offering remittance services for flat fees, this role may increase in the future. However, for now, it is not all that significant. In some countries, figures are not available. In other member states of the OECS, numbers of transactions number in the low thousands, and the average per transaction is generally less than \$100.<sup>92</sup> It is assumed that the postal system accommodates people with low incomes without accounts at banks or credit unions, and often in locations where access to Western Union or Money Gram requires travel.

Net of these institutions, there is still a role played by the “mule”, namely the person who physically transports cash. One Western Union agent cited this as a competitive challenge, but it is impossible to quantify how much informal trafficking continues.

### **Gaps and Vulnerabilities**

There are a few major gaps that limit the amount of remittance inflows and other private transfers to the OECS economies. Additionally, there is little in the market that provides incentives for keeping funds in accounts for savings and investment. Key gaps and constraints are highlighted below:

#### ***Weakness in the consolidation of surplus funds***

- The financial sector consolidates surplus funds from the market and this appears to be accomplished smoothly. In fact, Barbados and Trinidad and Tobago could even be said to have surplus liquidity, based on relatively low rates of lending as a proportion of banking sector assets. The one potential gap regarding funneling funding into the financial system concerns remittances, which are estimated to account for 4.3 percent of GDP in the OECS (the countries in which remittances were analyzed for this study).

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<sup>92</sup> For instance, averages were \$70-\$85 per money order received from abroad in Antigua and Barbuda, Dominica and Montserrat. In St. Kitts and Nevis, the average has been \$25-\$35 from 1999-2001. In Anguilla, the average transfer received was less than \$10 in 1999. See <http://www.upu.int/>.

### ***Few Customized Financial Products to Attract Greater Inflows***

- There is a general lack of information about the overseas OECS communities. While there is some organization and communication, largely through embassies and High Commissions in North America and the UK, there is very little coordination with the financial community. Apart from some initial approaches and market research, financial institutions in the OECS do not appear to make much of an effort to cater to these communities apart from the normal rendering of products and services they offer to their general client base. As a result, there do not appear to be any specially developed financial instruments to attract their business from abroad. This means there is less incentive for remittances received by family and friends to be used for anything but immediate consumption. The exception has been the willingness to make mortgage loans for investment in housing.

### ***Weak Incentives for Long-term Savings Instruments for Investment***

- There is a need for long-term deposit instruments in the OECS markets that pay adequate rates. There is reported to be a fair amount of interest-rate sensitivity in the OECS markets, meaning that people will extend the maturities of their deposits if rates are attractive enough. However, for the moment, interest rates paid are considered low. Part of this results from banks having “excess liquidity”, meaning that banks have sufficient regional pools of funds from which to borrow that they do not need to pay higher interest rates to attract deposits. Lower rates reduce the willingness of recipients to keep funds in accounts on a term basis. In addition to interest rate sensitivity, there is foreign exchange (devaluation) risk. While the OECS member states have maintained their pegged exchange rate for decades, there are periodic concerns that the peg is unsustainable. While no change is projected any time soon, the risk is said to be a factor among prospective investors who might consider buying securities. In terms of the typical transfer that is relatively small, there is little incentive to keep it in accounts on a term basis, particularly as they are usually income supplements. Thus, remittances received are generally spent very quickly, with little investment impact on the economy.

### ***Weak Condition and Limited Services of the Credit Unions***

- The credit union movement is not as strong as it should be. The credit unions could fill some (not all) of the gap not covered by the banks, as well as handle remittances on a more affordable basis than rates charged by money transfer companies. However, credit unions appear to need significant strengthening in a number of areas, including credit risk evaluation, mortgage underwriting, electronic technologies, use of debit cards and ATMs, corporate governance, internal audit, risk management systems, and internal reporting. Apparently, credit unions also do not adhere to uniform accounting standards, making it difficult to benchmark performance against peers to be responsive and competitive. Until these fundamentals are addressed and strengthened, there may be some reluctance to see the credit unions play any more of a role than they currently are. Moreover, the credit unions will have to demonstrate considerable increases in capacity if the authorities are to contemplate any legislative changes, such as the right of credit unions to deal in foreign exchange. By extension, there are also constraints on the capacity that is available at the various Departments of Cooperatives, the office (usually in a Ministry of Labor and Social Affairs) that is responsible for oversight.

### ***Role of Money Transfer Companies***

- Financial intermediaries, that are perceived as being unregulated and excessively costly, sometimes criticize money transfer companies. Thus, there are suggestions in some quarters that they should come under stricter regulation. At a minimum, some financial intermediaries complain that there is not a level playing field. The criticism is mainly targeted at Western Union, as RBTT is an agent for Money Gram in most OECS countries. However, here, they only receive remittances, and do not send out transfers. (According to RBTT, this is due to technology issues. They do send remittances via

Money Gram from Trinidad and Tobago and other non-OECS markets. Other Money Gram agents also send out transfers.)

### **Payment Systems and Telecommunications**

- Wire transfers are currently administered via FX accounts in correspondent banks, or directly between accounts if the bank has branches in both countries. This is not a major gap, although it is less efficient and more costly than an automated clearinghouse (as exists within and between the US and Canada). It also appears that the telecommunications markets of some OECS countries are a monopoly, and that enhanced competition might be helpful in increasing market acceptance and use of new telecommunications, bringing down costs and adding to productivity and efficiency.

### **Incomplete Statistics and Information**

- Remittance information is imprecise and inexact. While there are estimates based on collections through banks, money transfer companies, post offices, credit unions, and courier services, these are subject to error. The OECS figures appear reasonable. However, in terms of confidence, there is a limit to how useful these balance of payments figures are as compared to other line items that also are significant to the economy. Given their fairly substantial importance, the authorities might want to consider amending daily transaction reports that are submitted by financial institutions to be more precise about the type of “direct private transfer” that has been made. This would also mean making daily reports universally required, including from money transfer companies. If required, the money transfer companies would complain, as it would reduce the convenience associated with them as a mechanism for transfers, thereby reducing one of their clear competitive advantages. In any case, the onus on this should originate with the sending institution, and be communicated through correspondents so there is consistency at the receiving end. In the public sector, this may also call for an increase in statisticians and data management capacity, as steady and increasing demands for information are likely to persist.

### **Conclusions and Recommendations on Remittances**

There are at least two ways to enhance the economic development impact of remittances. One is to introduce interventions that reduce the cost of remittances, so that more funds are available to the end-user. This can be done by increasing competition so that remittance handlers lower their transaction fees, by strengthening the volume or concentration of funds such that handlers can attain economies of scale, and by improving transfer technology to lower processing costs. A second approach is to develop ways to utilize some of the remittance proceeds for development purposes.

USAID could play an important role in implementing interventions that both increase the use of remittance funds for longer-term investment and that reduce the cost of remittance transfers.

Two viable recommendations that support these roles are explained below.

#### **Develop community-based programs that help to leverage remittance flow for long-term investment**

We envisage two roles for USAID in inducing better remittance use: 1) program design and sponsorship; and 2) advocacy and market-building

- *Program design and sponsorship:* USAID could work with local institutions and other donors to develop strategic links or public-private partnerships that promote the consolidation of remittance flows for long-term community investment. (e.g., housing, health clinics, schools, roads, water). This recommendation is best captured by reference to examples of previous projects. In Haiti, there was a USAID project where one intermediary collects funds from remitters to finance fruit tree

cooperatives. The funds are then partly matched by a local donor organization. In another project, the intermediary allocates \$1.00 from every remittance to a fund to rehabilitate a local school for higher hurricane tolerance. One variation of these USAID projects that was implemented by a different sponsor working in some parts of Mexico has been the use of matching funds through hometown or national associations to stimulate investment in housing, infrastructure, and other community needs.<sup>93</sup> Such programs enable the intermediary to attract more remittance clients who wish to support the development effort (thus contributing to further economies of scale), as well as providing remitters an opportunity to contribute to local economic development that ultimately benefits the relatives, friends, and/or charities that they are trying to support.

- While it is up to the banks and other financial intermediaries to design instruments that capture remittances where the financial incentives make sense, USAID should coordinate with the IDB, Caribbean Development Bank (Basic Needs Trust Fund), World Bank Group and other interested parties to address rural and under served parts of the OECS where remittance flows could have an economic impact. Another option for USAID would be to serve as an information intermediary and advocate. To test and catalyze thinking of program ideas USAID could host a conference, with partners, to roll out considerations, plans, risks, and implementation requirements. USAID could provide substantial information for such a conference, with the intention of setting up working committees for follow through on initiatives. This could be coordinated with other institutions, with particular prominence given to CARTAC and its active supporters in financial sector issues, as well as the IDB and World Bank Group in terms of their regional experience with public-private partnerships. There would be a clear role for the Caribbean Development Bank in helping to coordinate the multitude of parties, as well as to provide insights into qualified institutions for specific tasks.
- A second role for USAID would be to design a pilot project, building on other elements of the recommendations. This would include working with some credit unions to design new products geared to the remittance market, and to apply such products to an active outreach program geared to existing or prospective members living abroad. The influx of new monies would be transferred via the IRnet project of WOCCU, and efforts could be made to support community-based initiatives supported by credit union members, a bit along the lines of the Mexican hometown associations. These would need a system to determine feasibility, sound capital structures, the sharing of risk, the potential for public sector co-financing, needed technical assistance for implementation, and a system of reporting to ensure accountability and integrity. The pilot would likely need to focus initially on basic needs or modest infrastructure, due to cost considerations and the unlikely prospects of major remittances being retained in accounts for long periods to finance development projects. It is also not likely to come on stream until other parts of a credit union strengthening program have been implemented. This would include a better functioning electronic and back-office system, as well as some of the other areas identified by credit unions themselves as current weaknesses. Lessons from USAID's experiences in Haiti and Guyana should be applied and customized to any OECS design. This could be the focus of a credit union workshop to include WOCCU, the Caribbean Confederation of Credit Unions, interested donors, NGOs, and Government officials.

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<sup>93</sup> As an example, in Zacatecas, Mexico, the state provides a 3-1 financing ratio for roads, schools, churches, water systems, and parks. See "Making the most of an exodus", *The Economist*, August 2, 2003.

### **Support for the widespread implementation of an international remittance network**

There is significant scope to strengthen the credit union movement and provide more OECS consumer options in remittances services by facilitating the implementation of the International Remittance Network (IRnet) initiative of WOCCU, which is coordinated by the Caribbean Community of Credit Unions (CCCU) – the apex organization. IRnet is a wire transfer service between credit unions that enables credit unions to implement money transfers at approximately one third the transaction cost of the money transfer companies. Participation in the Network would enable credit unions to lower the cost of money transfers; provide a wider range of payment services to their clients; and ultimately increase the number of clients and, correspondingly, funding resources. Closer integration of credit unions into the electronic system should have the benefit of reducing the costs of transfers to/from abroad, increasing the number of accounts in the financial system, and hopefully increasing the term funding base needed for lending and investment.

### Summary and Prioritization of Key Recommendations for Remittances

Strategic Intervention & Recommendations	Priority Sequencing	Potential Strategic Impact	Market Segments Affected	Technical Needs	Political Will/ Change Agent	Risks
Remittances						
<b>Support for development of community-based programs that help to leverage remittance flow for long-term investment</b>	Constructive – immediately implementable	Direct impact on financial intermediation Consolidation and use of remittances for investment will represent an increase in investment over consumption. If allocated efficiently, the funds would be expected to contribute to economic growth.	Local communities and most underserved areas in the OECS	Linkages with US-Canadian-LAC based groups Mechanisms for public-private partnership formation and funding	Moderately strong/CCCU and individual credit unions, hometown associations, Western Union	<ul style="list-style-type: none"> <li>Lack of confidence in the banking/ credit union systems undermines attractiveness of programs</li> <li>Use of funds do not stimulate investment or economic gains</li> </ul>
<b>Support for the widespread implementation of an international remittance network</b>	Constructive - but dependent on co-investment by credit unions	More competition among remittance handlers will lead	Local communities and most underserved areas in the OECS	Technical expertise in IRnet development Credit union operations specialists	Unclear/CCCU, individual credit unions, WOCCU	<ul style="list-style-type: none"> <li>Returns from the systems implementation investment are low or negative due to weak market demand</li> <li>Credit unions</li> <li>Lack of confidence in the banking/ credit union systems undermines attractiveness of programs</li> </ul>

## APPENDIX A: IMPACT INDICATORS AND INDICATIVE TECHNICAL REQUIREMENTS

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94</sup> s)
<b>Strengthen conditions for and improve access to SME finance</b>	<ul style="list-style-type: none"> <li>Quantification of the type and source of demand for SME finance in the real sector</li> <li>Increased capacity for SME financing</li> <li>Establishment of risk screening tools</li> <li>Strengthened culture for information disclosure</li> <li>Improvements in the type and suitability of financing products made available to SMEs</li> <li>Increase in the scope and volume of published information on SME financing</li> <li>SMEs become a more commonly targeted marketing segment for local banks</li> </ul>	<ul style="list-style-type: none"> <li>Increase in volume of credit to SME segment should lead to economic growth and jobs</li> <li>Lower costs of finance will make formal finance more attractive</li> <li>Increase in employment</li> <li>Improved government policies supporting the SME segments</li> <li>Increase in the number of finance programs offered to SME segment deepens the financial market</li> <li>Increase in the flow of funds between formal sector and informal sector realized better resource allocation</li> <li>Increase in venture capital financing reduces balance sheet leverage and credit risk</li> </ul>	<p><u>Phase I</u> SME Market assessment</p> <p>If market assessment indicates strong latent demand, then Phase II</p> <p><u>Phase II</u> Multicomponent approach suited to the findings of the assessment</p>	<p><u>Phase I</u> 2-3 specialists: SME finance, middle market banker, BDS professional</p> <p><u>Phase II</u> Credit Bureaus: Credit reporting specialist, local and international legal advisor, systems specialist</p>	<p><u>Phase I</u> 60 MD</p> <p><u>Phase II</u> Credit Bureaus: 100 MD per country; 260 MD regional</p> <p>Collateral Systems: 120MD per country</p> <p>SME Banking Development: Varied, 30 MD-60 MD</p> <p>Information systems: 80MD</p>
<b>Support for development of a coherent framework for NBFi regulation</b>	<ul style="list-style-type: none"> <li>Regulatory frameworks created and supported by coherent laws, regulations and standards; frameworks support proportionality, and neutrality in cost of regulation,</li> <li>Supervisors are trained in regulation by risk (not fiat) and are equipped with good judgment</li> </ul>	<ul style="list-style-type: none"> <li>Reduced systemic risks reduces risk premiums and supports investment</li> <li>Cost of administering regulation is reduced; less burden on govt</li> <li>More even development and competition between NBFIs and banks leads to lower costs</li> <li>Increased financial intermediation</li> </ul>	<p>Could be addressed in separate components or as part of single program</p> <p><u>Policy Coherency</u>: Initiated by a presentation series on <i>integrated</i> regulation to senior policy makers; followed up by specific</p>	<p><u>Policy Coherency</u>: 1-2 specialists in integrated regulation</p> <p><u>Insurance</u>: 1-2 insurance regulation specialists, 1-2 insurance supervisors, 1 actuary, 1 insurance products specialist</p>	<p><u>Policy Coherency</u>: 60-80 MD for seminars; varied thereafter based on level technical needs</p> <p><u>Insurance</u>: 520 MD-800 MD</p> <p><u>Credit Cooperatives</u>: 200</p>

<sup>94</sup> MD = Man days

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
	<ul style="list-style-type: none"> <li>Create a platform for inter-regional cooperation and risk-sharing (e.g. among insurance companies)</li> <li>Create a regulatory structure for credit unions that leverages SROs</li> <li>Establish an effective regulatory function to strengthen insurance company development</li> </ul>	<p>among FI's in the region improves capital flows for investment</p> <ul style="list-style-type: none"> <li>Costs of regulation neutral to risks of sector activities, creates a level playing field for development</li> <li>No evidence of regulatory arbitrage, supports efficient development</li> <li>Credit unions become part of the regulatory regime (if even through SRO functions)</li> <li>Insurance companies offering fairly priced and reliable products</li> </ul>	<p>target programs depending on country needs</p> <p><u>Insurance:</u> Requires dedicated assistance</p> <p><u>Credit Cooperatives:</u> Requires some dedicated assistance</p>	<p><u>Credit Cooperatives:</u> 1 SRO specialist, 1-2 credit coop regulatory specialists, 1 rural finance specialist</p>	MD – 400 MD
<b>Support for strengthening of deposit protection in OECS</b>	<ul style="list-style-type: none"> <li>Creation of an explicit deposit protection scheme(s) across the OECS that limits govt assurances and strengthens market discipline (does not have to be insurance)</li> <li>More public disclosure on the extent of government assurances in the financial sector</li> </ul>	<ul style="list-style-type: none"> <li>Greater competition for large institutional deposits lowers costs of funding</li> <li>More retail deposits flowing into the OECS (not necessarily to state-controlled banks) increases savings mobilization to healthy banks</li> <li>More market-based pricing for institutional deposits improves efficiency of price discovery and risk analysis</li> <li>Reduced reliance on forced savings as a means of protection leads to more market based system</li> <li>Strengthened confidence in banking system supports capital flows</li> </ul>	<p>Would require a phased approach as follows:</p> <p><u>Phase I:</u> Assessment of state of market and benchmarking</p> <p><u>Phase II:</u> Development viable options for deposit protection (includes both insurance and non-insurance options)</p> <p><u>Phase III:</u> Public/institutional consultation of options</p> <p><u>Phase IV:</u> Option selection and implementation</p>	<p>1 deposit insurance specialist; 1 insolvency specialist, 1 central bank policy specialist</p> <p>If deposit insurance selected as option, a pricing specialist would be needed in Phases III and IV</p>	<p><u>Phase I:</u> 30 MD</p> <p><u>Phase II:</u> 30-60 MD</p> <p><u>Phase III:</u> 30-60 MD</p> <p><u>Phase IV:</u> 180-260 MD</p>
<b>Support for development of crises contingency</b>	<ul style="list-style-type: none"> <li>Development of a concise strategy and decision-making</li> </ul>	<ul style="list-style-type: none"> <li>Lower risk premiums on capital and capital flows encouraging</li> </ul>	<p>Program would likely involve: 1) an inception phase covering</p>	<p>1 central banking specialist, 1 banking policy advisor, 1 bank</p>	260 MD – 500 MD

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
<b>frameworks</b>	framework for dealing with distressed institutions <ul style="list-style-type: none"> <li>• Risk mapping to show where vulnerabilities exist in the sector</li> <li>• Detailed procedures for resolving financial failures</li> <li>• Trained regulators and policymakers</li> </ul>	more investment <ul style="list-style-type: none"> <li>• Strengthened confidence and stability in financial system</li> <li>• More coordination and communication among countries when shocks occur</li> </ul>	assessment, framework outline, and a workshop; 2) framework and procedures development; 3) scenario testing of the framework; 4) training; and 5) documentation and outreach to industry	regulators with experience in resolutions, 1 banking auditor	
<b>Support for strengthening of public governance and market-orientation of state-controlled banks</b>	<ul style="list-style-type: none"> <li>• Identifiable governance structures in state-controlled institutions</li> <li>• More diverse representation on the Boards of Directors</li> <li>• Key risks and vulnerabilities within the state-controlled institutions identified and analyzed</li> <li>• Governments establish a long, intermediate and short-term plan for bank restructuring</li> <li>• Creation of an official mechanism for public monitoring of state-controlled institutions</li> </ul>	<ul style="list-style-type: none"> <li>• Improvements in the efficiency and operation of state-run institutions leading to better financial service</li> <li>• Strengthened confidence in state-controlled banks leading to more stable intermediation</li> <li>• More balance resource allocation between public and private sector projects leading to more efficient resource usage and more jobs in private sector</li> </ul>	<u>Governance:</u> Roll-out would likely involve the placement of an advisor at both the government level and in a Board advisory capacity at target institutions  <u>Restructuring:</u> Likely execution in four phases: 1) diagnostic of problem; 2) financial restructuring; 3) operational restructuring; 4) disposition and/or management of bad assets	<u>Governance:</u> 1 corporate governance advisor; 1 audit-qualified banking specialist  <u>Restructuring:</u> 2-3 restructuring specialists and team of local professionals; Would recommend that asset mgt may be outsourced to Jamaica's AMC	<u>Governance:</u> 260 MD – 500MD  <u>Restructuring:</u> Varied depending on scale of required activities
<b>Support for harmonization and integration of regional securities exchanges</b>  <i>Part I: Support for harmonization of operations and regulations</i>	<ul style="list-style-type: none"> <li>• Harmonization of standards, regulations and practices across exchanges</li> <li>• Comparability of the existing securities exchanges in terms of trading systems, settlement and clearance, and compliance with international standards</li> </ul>	<ul style="list-style-type: none"> <li>• An increase in the number of cross-listings improves viability of exchanges and helps risk diversification</li> <li>• An absolute increase in the number of listings in the region viability of exchanges and cross-investment among countries</li> <li>• Viability of regions exchanges will</li> </ul>	<u>Harmonization:</u> Roll-out would likely involve at least one advisor placed at each cooperating exchange and one or two liaison advisors to mediate among securities regulators; Program to be sequenced as: 1) Assessment and gap	<u>Harmonization:</u> 3-4 securities regulatory specialists, 1-2 exchange specialists, 1-2 systems specialists	<u>Harmonization:</u> 1000 MD-1500 MD

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
		<p>help to prevent further deterioration of business environment</p> <ul style="list-style-type: none"> <li>Strengthened market governance and more consistency in regulation will support increased investment</li> </ul>	analysis; 2) Road map and prioritization; 3) Implementation plan and resource allocation; 4) execution and procurement; 5) facilitation and market outreach		
<i>Part II: Support for implementation of a virtual securities exchange</i>	<ul style="list-style-type: none"> <li>Regional consensus on the creation of a virtual integrated exchange</li> <li>Successful setup and operation of a virtual integrated exchange</li> <li>Emergence of new risk diversifying products Reduction in the overall level of debt across the region</li> </ul>	<ul style="list-style-type: none"> <li>Harmonization and integration taken alone or together seek to achieve the same goals of increasing capital flows, providing viable exit options for successful entrepreneurship, promoting viability of the regions exchanges, and helping to diversify risk</li> </ul>	<p><u>Integration:</u> Roll-out would involve: 1) Examination of viable systems options; 2) Establishment of regional working group and consensus building; 3) TA for systems design and installation (born by exchanges); 4) development of business plan</p>	<p><u>Integration:</u> 1 securities regulatory specialists, 1-2 exchange specialists, 2 systems specialists</p>	<p><u>Integration:</u> Varied, but would likely require full-time commitment of 3 people over a year and 1000 MD of STTA</p>
<b>Support for accounting reform and disclosure in OECS</b>	<ul style="list-style-type: none"> <li>Improved laws on disclosure</li> <li>Improved legal frameworks promoting compliance with OECS principles of disclosure and governance</li> <li>Certification and training in place</li> <li>Harmonization of standards in the region and to international practice</li> </ul>	<ul style="list-style-type: none"> <li>Widespread adoption of international accounting standards will improve disclosure and quality of financial reporting; improved reporting will lower the cost of risk analysis and improve the efficiency of capital allocation; Efficient capital allocation encouraged economic growth by channeling resource to the most productive sectors</li> </ul>	1-2 accounting policy advisors working with the ECCB, ICAC, local organizations, and relevant govt counterparts to establish an Institute of Chartered Accountants; Work would involve institutional set-up, linkages with IAS/IFRS boards, training, and chart of accounts development	1-2 international accounting specialists and a small group of local audit professionals	300 MD - 600 MD
<b>Support for the development of</b>	<ul style="list-style-type: none"> <li>Guarantee mechanisms setup under each of the country</li> </ul>	<ul style="list-style-type: none"> <li>Reduction in the probability/frequency of failed</li> </ul>	Implementation would likely include one or more	Short-term assistance from one or more	200-400 MD

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
investor protection schemes	<p>exchanges or regionally</p> <ul style="list-style-type: none"> <li>Public outreach and education on the risks and rewards of exchange-related investing</li> </ul>	<p>transactions and reductions in investor losses will lead to increased confidence from retail investors and smaller institutional investors; Increased confidence should lead to more attractive investment opportunities for retail investors</p>	<p>of the following: 1) operations review and risk assessment of each relevant exchange; 2) international benchmarking; 3) development of viable options, including the possibility of establishing a regional mechanism; 4) assistance on implementation</p>	<p>advisors who will work each exchange in evaluating options, reviewing international experience, and establishing the protection mechanisms</p>	
Support for the development of non-bank debt markets	<ul style="list-style-type: none"> <li>Improvements to exchange systems that allow accurate and reliable settlement of fixed income transactions</li> <li>The creation of a credible and independent regional rating agency</li> </ul>	<ul style="list-style-type: none"> <li>Lower borrowing costs will make non-bank debt funding</li> <li>Growth in public listings of corporate bonds will help, if traded on exchanges, would help to support viability of exchanges</li> <li>Reduced reliance on bank funding will help to diversify system risk, and increase supply-side competition for financing</li> </ul>	<p><u>Settlement systems:</u> Implementation would follow similar pattern as above on market integration: 1) diagnostic; 2) option evaluation and consensus building; 3) implementation planning; 4) implementation; 5) post implementation facilitation</p> <p><u>Debt Rating Agency:</u> If done by private sector, high-level suggestions are outline in main body of report; If led by donors, them approach would likely require an in-depth assessment and feasibility study to test whether a regional agency would make sense and whether it</p>	<p><u>Settlement systems:</u> 1 fixed income transaction specialist; 1 clearing systems specialist</p> <p><u>Debt Rating Agency Through Private Sector:</u> 1-2 debt rating agency specialists; 1 fixed income transaction advisor</p> <p><u>Debt Rating Agency Through Incubation:</u> 2 debt rating agency specialists, 1 systems specialist, 5+ local professionals</p>	<p><u>Settlement systems:</u> 100 MD – 200 MD</p> <p><u>Debt Rating Agency</u> 100 MD – 1500 MD</p>

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
			should be incubated, developed virtually, or country-specific		
<b>Support to strengthen Jamaican securities markets</b>	<ul style="list-style-type: none"> <li>• An improved business profile for the JSE</li> <li>• An improved business profile for JSCD</li> <li>• Increased capacity of JSCD to provide bondholder registrar services and mark-to-market valuation services to the marketplace</li> <li>• An improved environment for mutual funds and growth in the number of mutual fund registrations</li> </ul>	<ul style="list-style-type: none"> <li>• An improved business profile for the JSE will help to support its viability and help it to contribute to investment</li> <li>• An improved business profile for JSCD will do the same and maximize use of its technical resources</li> <li>• Increased capacity of JSCD to provide bondholder registrar services and mark-to-market valuation services to the marketplace will support (for the time being) the large repo market and minimize some of the risks that stem from large public debt funding</li> <li>• An improved environment for mutual funds and growth in the number of mutual fund registrations would open up new investment channels for investors and set the stage for the mobilization of long-terms savings, such as in the form of pensions</li> </ul>	Technical requirements varied, but would involve series of short-term engagements	1 stock exchange specialist 1 clearing and depository specialist 1 fixed income specialist 1 mutual fund regulatory specialists 1 mutual fund investment specialist	300 MD - 400 MD
<b>Support for development of community-based programs that help to leverage remittance flow for long-term investment</b>	<ul style="list-style-type: none"> <li>• Establishment of viable and active community-based programs</li> <li>• Increased awareness of local institutions and governments of the potential value of remittance flows</li> </ul>	<ul style="list-style-type: none"> <li>• Increased retention and use of remittances for long-term investment will help savings mobilization and provide a stable base of funding for long-term investment</li> <li>• Long-term funding will help</li> </ul>	Technical program requirements would vary, but would likely require resources in and access to both foreign and local communities	Short-term advisor(s) in development similar programs	100 MD – 300 MD for assessment and design  Time requirements would vary for implementation

Strategic Intervention & Recommendations	BENCHMARKS AND IMPACT		INDICATIVE TECHNICAL AND RESOURCE REQUIREMENTS		
	Key Performance Benchmarks	Impact on Financial Intermediation	Project Outline	Staffing Requirements	Est. Level of Effort (MD <sup>94s</sup> )
	<ul style="list-style-type: none"> <li>Greater coordination among the target countries in the collection and security of remittances</li> <li>Greater coordination between local communities and overseas nationals</li> </ul>	<p>institutions to match fund their balance sheets and reduce risks of operation; Reduced risks translate into lower costs of financial services and more system stability</p> <ul style="list-style-type: none"> <li>More widespread donor involvement in developing programs will help to facilitate productive uses of remittances and strengthen the relationships between indigenous populations and foreign nationals; Strengthened relationships would help to establish a good foundation for entrepreneurship and job growth</li> </ul>	Advisors would first center on working with the two groups, liaising with donors and government; They would then introduce program designs, test their feasibility, and consensus build around solutions		
<b>Support for the widespread implementation of an international remittance network</b>	<ul style="list-style-type: none"> <li>Credit unions in wide range of areas achieve capacity in handling remittance flows and money transfers</li> <li>Systems are expanded to either individual institutions or through shared or outsource facilities</li> </ul>	<ul style="list-style-type: none"> <li>Increase capacity of credit unions to handle remittances in under-served areas would support increased savings mobilization and bear a positive social impact on citizens in under-served areas</li> <li>Increased competition in receiving and handling remittances will lower costs and encourage new remittance flows</li> </ul>	<p>Technical program would likely seek to leverage services through WOCCU</p> <p>Program would want to seek public private participation with WOCCU members in funding and TA</p>	1-2 remittance systems specialists dedicated to supporting the capacity building and helping in outreach and training	May not require direct TA support from USAID, but if so level of effort likely to be minimal – 100 MD – 200 MD

## APPENDIX B: LIST OF PEOPLE INTERVIEWED

**Mr. McAlister Abbott**

*Managing Director*  
Antigua Barbuda Investment Bank Ltd.  
Antigua & Barbuda

**Mr. Kenny Byron**

*Managing Director/CEO*  
Bank of Antigua,  
Antigua & Barbuda

**Mr. Brian Murdock**

*Country Manager*  
Bank of Nova Scotia  
Antigua & Barbuda

**Mr. Jonathan Lindsey**

*Assistant Manager*  
Bankers' Association  
Antigua & Barbuda

**Mr. Lebrecht Hesse**

*Chairperson*  
Financial Service Regulatory Commission  
Antigua & Barbuda

**Mr. Fitzroy Warner**

*Head of Corporate Banking,*

**Ms. Icilman Francis Pigott**

*Senior Corporate Manager*  
First Caribbean Bank  
Antigua & Barbuda

**Ivan Browne**

*Corporate Banking Director*  
First Caribbean International Bank  
Antigua & Barbuda

**Mr. Calvin Parker**

*Deputy Financial Secretary*  
Ministry of Finance  
Antigua & Barbuda

**Mr. Lennox Knowles**

*Manager*  
Western Union  
Antigua & Barbuda

**Mr. Philbert Mason**

*Manager*  
Western Union  
Antigua & Barbuda

**Ms. Holly Peters**

*Executive Director*  
Antigua & Barbuda Chamber of Commerce  
Antigua & Barbuda

**Mr. McKay**

*President*  
Antigua and Barbuda Cooperative Credit  
Union Leage  
Antigua & Barbuda

**Mr. Kevin Quinlan**

*Private Sector Development Advisor*  
DFID Caribbean  
Barbados

**Mr. Stephen Cozier**

Bank of Nova Scotia  
Barbados

**Mr. Mariano Browne**

*President*  
Barbados Institute of Banking and Finance  
Barbados

**Mr. Tony L. Whittaker**

*CEO/Administrator*  
Barbados Institute of Banking and Finance  
Barbados

**Mr. Henderson Holmes**

*Financial Sector Consultant*  
Barbados Investment & Development  
Corporation  
Barbados

**Mr. Louis Greenidge**

*Managing Director*  
Barbados National Bank  
President of CAIB  
Barbados

**Ms. Tessa Pickering**  
*Acting General Manager*  
Barbados Stock Exchange  
Barbados

**Mr. Mariano Browne**  
*Managing Director*  
Caribbean Commercial Bank  
Barbados

**Mr. Ryan Buyer**  
*Development Officer*  
Caribbean Confederation of Credit Unions  
Barbados

**Mr. Neville Grainger**  
*VP (Finance)*  
Caribbean Development Bank  
Barbados

**Mr. Alan Slusher**  
*Director, Economics and Programming  
Department*  
Caribbean Development Bank  
Barbados

**Dr. Warren Smith**  
*Director, Finance and Corporate Planning*  
Caribbean Development Bank  
Barbados

**Mr. Adrian Debique**  
*Corporate Planning Division*  
Caribbean Development Bank  
Barbados

**Mr. Tony Maughn**  
*Private Sector Unit*  
Caribbean Development Bank  
Barbados

**Ms. Hazel Highland**  
Caribbean Financial Services Corp.  
Barbados

CARICOM Single Market and Economy  
Unit  
Barbados

**Mr. Nigel Bradshaw**  
*Coordinator*  
CARTAC  
Barbados

**Ms. Octavia Gibson**  
Central Bank Of Barbados  
Barbados

**Mr. Darcy Boyce**  
*Deputy Governor*  
Central Bank Of Barbados  
Barbados

**Ms. Joanne Goulet**  
*Counsellor (Development Assistance)*  
CIDA  
Barbados

**Mr. Leroy Paris**  
*CEO*  
Clico Holdings  
Barbados

**Mr. Anthony Hobbs**  
*Insurance Partner*  
Deloitte & Touche Barbados  
Barbados

**Ms. Jane Armstrong**  
**Bob Smith**  
*Head of Regional Unit*  
DFID Caribbean (Barbados)  
Barbados

**Mr. Charles Pink**  
*CEO*  
First Caribbean International Bank  
Barbados

**Mr. Horace Cobham**  
*Executive Director, Credit Risk  
Management*  
First Caribbean International Bank  
Barbados

**Ms. Sonia DeCambre,**  
**Mr. Bruce Hackitt**  
*Financial Sector Manager*  
Specialists  
IaDB (Barbados)  
Barbados

**Mr. David Deane**  
*First Vice President*  
Insurance Association of the Caribbean, Inc.  
Barbados

**Mr. Steve Stoute**  
*Director*  
Insurance Association of the Caribbean, Inc.  
Barbados

**Mr. Mismar Graves**  
Insurance Corporation of Barbados  
Barbados

**Ms. Winsome Leslie**  
*Caribbean Coordinator at Multilateral*  
*Investment Fund*  
Interamerican Development Bank  
Barbados

**Badrul Haque**  
Interamerican Development Bank  
Barbados

**The Hon. Glyne Murray, Senator**  
*Minister of State*  
Ministry of Finance and Economic Affairs  
Barbados

**Mr. Andrew Cox**  
*Permanent Secretary, Economics*  
Ministry of Finance and Economic Affairs  
Barbados

**Mrs. Juanita Thorington Powlett**  
*Permanent Secretary, Finance*  
Ministry of Finance and Economic Affairs  
Barbados

**Mr. Wayne Fields**  
*Financial Sector Partner*  
PriceWaterhouseCoopers  
Barbados

**Mr. Michael Bynoe**  
*Insurance Partner*  
PriceWaterhouseCoopers  
Barbados

**Mr. David Reid**  
*President*  
Prism Services Inc.  
Barbados

**Mr. Doug Maloney**  
Royal Bank of Canada  
Barbados

**Mr. Dodder Rich Alleyne**  
Sagicor Insurance Co.  
Barbados

**Mr. Neville Nichols**  
*Chairman*  
Securities Commission of Barbados  
Barbados

**Mr. Calvin B. Knowles**  
*Chairman*  
Securities Exchange of Barbados  
Barbados

**Mr. Hillary H. Deveaux**  
*Deputy Chairman*  
Securities Exchange of Barbados  
Barbados

**Mr. Carlos Belgrave**  
*Supervisor of Insurance*  
Supervisor of Insurance Office  
Barbados

**Mr. Anthony Palgrim**  
*General Manager*  
The Barbados Co-operative and Credit  
Union League  
Barbados

**Mrs. Patricia Charles**  
*General Manager*  
Agricultural Industrial & Development Bank  
Dominica

**Mr. Robert Frederick**

*General Manager*  
Bank of Nova Scotia  
Dominica

**Mr. Jean Melisse**

**Mr. Clarendon**  
*General Manager*  
Banque Francaise Commerciale - Antilles  
Guyane  
Dominica

**Mr. Yvor Nassief**

*General Manager*  
Cambio Man  
Dominica

**Mr. Ackroyd Birmingham**

*General Manager*  
Dominica Cooperative Credit Union League  
Ltd.  
Dominica

**Mr. Collin Bully**

*Executive Director*  
Export Development Unit, OECS  
Dominica

**Mrs. Mauricia Thomas-Francis**

*General Manager*  
First Caribbean International Bank  
Dominica

**Mr. Gerry Aird**

*Managing Director*  
H.H.V. Whitchurch & Company Limited  
Dominica

**Mr. Ambrose Sylvester**

*Permanent Secretary*  
Ministry of Finance  
Dominica

**Mrs. Rosamund Edwards**

*Senior Economist*  
Ministry of Finance  
Dominica

**Mr. Milton Lawrence**

*Chairman*  
National Commercial Bank of Dominica  
Dominica

**Mr. Bernard Ettinoffe**

*Executive Director*  
National Development Foundation of  
Dominica Limited  
Dominica

**Mr. Irish**

*Acting General Manager*  
Roseau Cooperative Credit Union  
Dominica

**Mrs. Lorene Johnsson**

*Manager of Operations*  
Royal Bank of Canada  
Dominica

**Mr. William Robinson**

*Manager*  
Bank of Nova Scotia  
Grenada

**Mr. Gillan Glean Walker**

*Business Advisor*  
Export Development Unit, OECS  
Grenada

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